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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 347

THE UNITED STATES, PETITIONER

vs.

ELLIS R. LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION FOR CERTIORARI FILED OCTOBER 6, 1950
CERTIORARI GRANTED DECEMBER 11, 1950

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 347

THE UNITED STATES, PETITIONER,

vs.

ELLIS R. LEWIS

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

INDEX

	Original	Print
Record from Court of Claims	1	1
Petition	1	1
General traverse	7	4
Argument and submission	7	4
Special findings of fact	9	4
Conclusion of law	13	8
Opinion, Madden, J.	13	8
Dissenting opinion, Whitaker, J.	17	11
Judgment	21	13
Clerk's certificate (omitted in printing)	23	
Order allowing certiorari		14

1 In the Court of Claims of the United States

No. 48903

ELLIS R. LEWIS, PLAINTIFF

vs.

UNITED STATES OF AMERICA, DEFENDANT

PETITION—Filed October 29, 1948

To the Honorable, the Chief Justice and the Judges of the Court of Claims:

Plaintiff, Ellis R. Lewis, by David & Fainman, his attorneys, respectfully represents:

1. The plaintiff is a citizen of the United States, and is a resident of the village of Oak Park, County of Cook and State of Illinois, and brings this action in his own right.

2. On or shortly prior to March 15, 1945, the plaintiff duly filed with the Collector of Internal Revenue, at Chicago, Illinois, his income tax return for the calendar year 1944, which said return showed a total income tax of $16,259.37. The plaintiff paid the said tax to the said Collector of Internal Revenue as follows:

2 Withheld from plaintiff's compensation by Accurate Spring Manufacturing Co. during the year 1944, the aggregate sum of..... $ 7,135.20

Payments made on plaintiff's declaration and amended declarations of estimated tax for 1944 as follows:

On or prior to March 15, 1944.....	$ 1,117.72
On or prior to June 15, 1944.....	2,294.78
On or prior to Sept. 15, 1944.....	1,706.25
On or prior to Jan. 15, 1945.....	4,005.42
	$16,259.37

3. On or about November 7, 1945, the plaintiff filed with the Collector of Internal Revenue at Chicago, Illinois, an amended income tax return for the said calendar year 1944, which showed a total income tax for the said year of $18,098.99, and the plaintiff paid therewith to the said Collector of Internal Revenue the sum of $1,839.62, being the balance due upon said $18,098.99, after crediting the sum of $16,259.37, amount theretofore paid as hereinbefore set forth. By reason of the late payment of the said sum of $1,839.62, the said Collector of Internal Revenue assessed against the plaintiff,

as interest and penalty, the sum of $71.34, which said sum was paid by the plaintiff to the said Collector of Internal Revenue on or about October 17, 1946.

4. During the entire calendar year 1944, the plaintiff was Vice President and General Manager of Accurate Spring Manufacturing Co. (for convenience sometimes hereinafter called the "Company"). The plaintiff's compensation agreement with the Company was that plaintiff was to receive a salary of $12,000 for said year, and in addition thereto a bonus of 10% of the amount of the net profits of the Company (before deductions for any salary of the President of the Company in excess of $17,500.00 and any bonuses to
3 other employees of the Company) and an additional bonus of $3,000.00 (for convenience said 10% bonus is hereinafter called "bonus").

5. In truth and in fact, the said agreement was that, for the purpose of computing the plaintiff's said bonus, "net profits" were the net profits of the Company *after* deducting therefrom federal income taxes thereon. The bonus to which the plaintiff was entitled, computed in accordance with said agreement, amounted to $11,067.94.

6. The plaintiff erroneously and mistakenly believed and understood the said agreement to be that, for the purpose of computing the plaintiff's said bonus, "net profits" were the net profits of the Company *before* deducting therefrom federal income taxes thereon. Pursuant to said mistake of fact as to said agreement, the plaintiff withdrew and received from the Company as part of his compensation for the calendar year 1944, a bonus in the sum of $21,924.00 computed on net profits before deducting therefrom federal income taxes thereon, which said bonus was $10,856.06 in excess of the amount to which he was entitled from the Company for said year under the said agreement as it actually was.

7. The Company, when it filed its original income tax return for 1944, which tax it paid, deducted, as part of the compensation paid to the plaintiff, the sum of $21,924.00, the bonus paid to the plaintiff as the result of said mistake of fact. In 1945, after discovering the said mistake, the Company filed an amended return, in which it deducted, as compensation to the plaintiff, only the sum of $11,-067.94, the bonus correctly computed and to which the plaintiff was actually entitled, and it paid the additional tax due from the Company under said amended return.

4 8. In a suit between the plaintiff and the Company in the Circuit Court of Cook County, Illinois, the Company filed a counterclaim against the plaintiff to recover the excess bonus mistakenly computed and paid, as aforesaid. By decree of said court,

entered November 15, 1946, the court found the facts to be as alleged in paragraphs 4, 5, and 6 above, and decreed that the Company was entitled to the return of said $10,856.06, and entered a judgment against the plaintiff herein accordingly. The plaintiff, pursuant to the said decree, refunded the said money to the Company on November 15, 1946.

9. The plaintiff's adjusted gross income for 1944, as shown on his aforesaid amended return filed on or about November 7, 1945, was $40,177.62. In truth and in fact, the plaintiff's adjusted gross income for 1944 was $29,321.56, being the said sum of $40,177.62, after excluding therefrom the sum of $10,856.06, the excess bonus received by the plaintiff as a result of said mistake of fact and refunded by him to the Company, as aforesaid. The plaintiff's income tax for the calendar year 1944, computed upon his said true and correct adjusted gross income for said year of $29,321.56, is $10,953.17, which is $7,145.82 less than the tax actually paid by the plaintiff. The plaintiff has, therefore, overpaid to the United States of America the sum of $7,217.16, being the excess income tax for the year 1944 paid by the plaintiff in the sum of $7,145.82 and the interest and penalty wrongfully and illegally assessed against the plaintiff and paid by him in the sum of $71.34.

10. On March 25, 1947, the plaintiff filed with the Collector of Internal Revenue, at Chicago, Illinois, a claim for refund of income taxes for the calendar year 1944, and interest and penalty on part thereof, in the amount of $7,217.16, based on the facts hereinbefore set forth.

5 11. Thereafter, and on or about October 3, 1948, the plaintiff received by registered mail a notice from the Commissioner of Internal Revenue, dated September 28, 1948, advising him of the disallowance in full of the said claim for refund.

12. Under the said claim for refund of $7,217.16 filed by the plaintiff as aforesaid, the plaintiff was and is entitled to a refund of the income tax, and interest and penalty on part thereof, paid by the plaintiff in that amount, as aforesaid, and the disallowance of the claim for refund was wrongful and illegal, and the United States of America is now wrongfully and unlawfully withholding from the plaintiff, without his consent and against his will, the said amount of $7,217.16, with interest thereon.

13. The plaintiff is and has always been the sole owner of the claim herein referred to, and has not assigned or transferred the whole or any part thereof, or interest therein. The plaintiff has at all times borne true allegiance to the Government of the United States, and has not in any way aided, abetted, or given encouragement to rebellion against the Government.

14. Plaintiff believes that the facts stated herein are true, and avers that he is justly entitled to recover the amount claimed from the United States of America, after allowing all just credits and offsets.

WHEREFORE, plaintiff prays for judgment against the United States of America in the sum of Seven Thousand, Two Hundred, Seventeen Dollars and Sixteen Cents ($7,217.16), with interest from
6 the respective dates of payment, as provided by law, and his costs herein.

ELLIS R. LEWIS,
Plaintiff.

DAVID & FAINMAN,
Attorneys for Plaintiff,
Suite 1663,
38 South Dearborn Street,
Chicago 3, Illinois.

Duly sworn to by Ellis R. Lewis. Jurat omitted in printing.

7-8 GENERAL TRAVERSE—Filed November 8, 1948

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

(S.) THERON L. CAUDLE,
Assistant Attorney General.

J.H.S.

ARGUMENT AND SUBMISSION OF CASE

On June 6, 1950, the case was argued and submitted on merits by Mr. Arthur C. Chapman for plaintiff, and Mr. Joseph H. Sheppard for defendant.

9 **Special Findings of Fact, Conclusion of Law and Opinion of the Court by Madden, Judge. Dissenting Opinion by Whitaker, Judge**—Filed July 10, 1950

Mr. Arthur C. Chapman for the plaintiff. *Messrs. David* and *Fainman* were on the brief.

Mr. Joseph H. Sheppard, with whom was *Mr. Assistant Attorney General Theron Lamar Caudle*, for the defendant.

This case having been considered by the Court of Claims, the court, upon the evidence and the report of a commissioner, makes the following

SPECIAL FINDINGS OF FACT

1. The plaintiff is a citizen of the United States and is a resident of the village of Oak Park, county of Cook and State of Illinois.

2. On or shortly prior to March 15, 1945, plaintiff filed with the Collector of Internal Revenue at Chicago, Illinois, his income tax return for the calendar year 1944, which return showed a taxable income for the year of 1944 of $37,472.30, and a total income tax of $16,259.37. The tax was paid to the Collector of Internal Revenue as follows:

Withheld from plaintiff's compensation by Accurate Spring Manufacturing Co. during the year 1944, the aggregate sum of	$ 7,135.20
Payments made on plaintiff's declaration and amended declarations of estimated tax for 1944 as follows:	
On or prior to March 15, 1944	1,117.72
On or prior to June 15, 1944	2,294.78
On or prior to September 15, 1944	1,706.25
On or prior to January 15, 1945	4,005.42
Total	16,259.37

10 3. On or about November 7, 1945, plaintiff filed with the Collector of Internal Revenue at Chicago, Illinois, an amended income tax return for the year 1944, which showed plaintiff's taxable income for 1944 as $40,177.62, and a total income tax of $18,098.99; and plaintiff paid therewith the sum of $1,839.62, being the balance due after crediting the sum of $16,259.37, the amount theretofore paid. By reason of the late payment of the sum of $1,839.62, the Collector of Internal Revenue assessed against plaintiff, as interest, the sum of $71.34, which sum was paid to the Collector of Internal Revenue on October 18, 1946.

4. Plaintiff was during the entire calendar year 1944, and for some years prior thereto, vice president, a member of the Board of Directors, and general manager of Accurate Spring Manufacturing Co., sometimes hereinafter called the "company". During 1944 he was in active charge of the entire operation of the company and, among other things, he did all the hiring and discharging, executed all the contracts, signed checks along with the individual who was the bookkeeper and assistant treasurer of the company, and directed the policies of the company. The president of the company, Frank D. Weber, was in Florida during the year 1944, and during no time in that year participated in the conduct of the business of the company other than by one or two telephone conversations with plaintiff and

one or two meetings with plaintiff, once in New York City and once in Ashland, North Carolina.

5. In December 1938 plaintiff had been selected by the president of the company to be the general manager effective January 1, 1939. It was then agreed between plaintiff and the president that in addition to a stated salary, plaintiff was to receive a bonus of 10 per cent of the net profits of the company before deduction for taxes. For the years 1939 and 1940 plaintiff was paid on that basis. Some time late in 1941 the president and plaintiff discussed the matter of plaintiff's bonus and the amount of compensation which he would receive on the existing basis due to the large increase in the company's profits from its increased business. It was decided, however, that no change would be made until after the profits for 1941 had been determined.

11 Early in 1942, after the profits for 1941 had been determined, plaintiff was presented with a statement showing the bonuses to be paid him, based on computations of the bonus both before and after deduction for taxes. Plaintiff agreed to accept for that year the bonus computed after deduction for taxes, and plaintiff was paid on that basis for 1941. Without further agreement between plaintiff and the president of the company, the compensation for the years 1942 and 1943 was likewise paid on the basis of the computation after deduction for taxes.

6. For the year 1944, without further agreement between plaintiff and the company, plaintiff directed payment to himself of a bonus on the basis of a computation on profits before deduction for taxes. On this basis the bonus paid to plaintiff was $21,924. Plaintiff at the time believed that that was the agreement upon which he was entitled to have his bonus computed, notwithstanding the acceptance by him of the bonus for 1941, 1942, and 1943 on the basis of a computation after deduction for taxes.

7. The company, in its income tax return for 1944 filed in March 1945, deducted as a part of the compensation paid to officers the sum of $21,924 as paid to plaintiff. The company's tax was computed and paid accordingly. Later in 1945 the company filed an amended return in which it deducted as bonus compensation to plaintiff the sum of $11,067.94, instead of the $21,924 deducted in its original return. The additional tax based on the recomputation was paid by the company.

8. Some time after the company's return for 1944 had been filed, plaintiff was discharged from his position with the company. Following his discharge, plaintiff brought suit against the company, claiming, among other things, that by reason of deductions of improper items as expense, the profits before taxes were stated too low

and that a larger bonus should have been paid to him for 1944. The company filed a counterclaim, claiming, among other things, improper action on the part of plaintiff in directing payment to himself of a bonus computed on the profits before taxes, and that thereby plaintiff received as a bonus $21,924 instead of $11,067.94, which was the correct amount computed after deduction for taxes.
12 At the trial plaintiff testified that the agreement was to pay a bonus based on profits before taxes.

On December 3, 1946, judgment was entered as of November 15, 1946. The court found that the agreement for 1944 was that the bonus should be computed on the profits after deduction for taxes and that plaintiff erroneously and mistakenly believed and understood that the bonus was to be computed before deduction of taxes, and that by virtue of this mistake plaintiff received for the year 1944 the sum of $10,856.06 in excess of the amount to which he was entitled under the agreement as found by the court. Judgment was for the company in an amount which included the indicated excess of the bonus payment.

9. Plaintiff's taxable income for 1944 as shown on his amended return for that year, filed on November 7, 1945, was $40,177.62, and this sum included the sum of $21,924 as plaintiff's bonus from Accurate Spring Manufacturing Co. for 1944, based upon a percentage of the net profits.

10. Excluding from said taxable income the sum of $10,856.06, which is the amount that the Circuit Court of Cook County, Illinois, decreed was improperly paid to plaintiff, and which he repaid to Accurate Spring Manufacturing Co. in 1946, the plaintiff's taxable income for 1944 would be $29,321.56.

11. Based on a net income of $29,321.56 for 1944, plaintiff's tax on his 1944 income would be $10,953.17, which sum is $7,145.82 less than the tax which was paid by plaintiff, not counting the sum of $71.34 interest paid by plaintiff because of the late payment of the tax. The sum of the two amounts is $7,217.16.

12. On March 25, 1947, plaintiff filed with the Collector of Internal Revenue at Chicago, Illinois, a claim for refund of income taxes for the calendar year 1944, and interest and penalty on part thereof, in the amount of $7,217.16, based on the facts hereinbefore set forth.

Thereafter, and on or about October 3, 1948, plaintiff received by registered mail a notice from the Commissioner of Internal Revenue, dated September 28, 1948, advising him of the disallowance in full of the said claim for refund.

13 CONCLUSION OF LAW

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court concludes, as a matter of law, that plaintiff is entitled to recover, and it is adjudged and ordered that he recover of and from the United States seven thousand two hundred and seventeen dollars and sixteen cents ($7,217.16), with interest as provided by law.

OPINION

MADDEN, *Judge*, delivered the opinion of the court:

The plaintiff sues to recover Federal income taxes paid by him on his income for the year 1944. He says that he paid more than he owed, and if he did he is entitled to recover the excess, since he filed a timely claim for refund which was disallowed. This is another case of a bonus paid to an officer of a corporation, a part of which bonus was, after the taxable year in question, repaid to the corporation because it was found that the bonus paid was larger than the officer was entitled to.

Beginning January 1, 1939, the plaintiff was the general manager of the Accurate Spring Manufacturing Company. His agreed compensation was to be a salary plus ten percent of the profits of the company before the deduction of taxes. He was so paid for the years 1939 and 1940. Late in 1941, the company's business and profits having greatly increased, the president of the company raised with the plaintiff the question of whether his compensation was not too large. It was agreed, however, that no change would be made until after the profits for 1941 had been determined. After that was done, the plaintiff agreed that his bonus for 1941 should be computed on net profits after the deduction of taxes.

No further discussion or agreement having taken place, the plaintiff's bonuses for the years 1942 and 1943 were computed on net profits after taxes. For the year 1944, however, the plaintiff, as the executive manager of the company, directed payment to himself of a bonus computed on profits before taxes. On this basis, he received a bonus of $21,924. The commissioner of this court found that the plaintiff at the time believed that he was entitled to be paid on
14 that basis. The Government took no exception to that finding, and we have made a finding to the same effect.

The plaintiff included the bonus of $21,924 in his income tax return for 1944, and paid the tax on it. The company in its return deducted the $21,924 as a business expense. In 1945 the company discharged the plaintiff, and he sued the company in an Illinois court, alleging that he was entitled to a larger bonus than he had received for 1944, because the company had deducted improper items as expenses, thus reducing its net profits and the plaintiff's

bonus. The company filed a counterclaim in the plaintiff's suit, asserting that the plaintiff had been overpaid, since his bonus should have been computed only upon profits after taxes. The Illinois court held for the company and required the plaintiff to repay to the company the amount by which the bonus received by him exceeded a bonus computed on profits after taxes. The excess was $10,856.06. The court found, as we have found, that the plaintiff mistakenly believed that the agreement between him and the company was that his bonus should be computed upon profits before taxes, but that in fact the agreement was that it should be computed on profits after taxes.

The plaintiff repaid the $10,856.06 to the company. The company filed an amended income tax return for 1944 in which it reduced its deduction and paid its tax on the amount repaid to it by the plaintiff. The plaintiff filed a claim for refund seeking the return of the tax paid by him on the $10,856.06 which he had been required to return to the company.

This court has held, in two recent cases, that when a taxpayer receives money which he supposes he is entitled to keep, and pays income tax on it, but later learns that he was mistaken in thinking he was entitled to keep it, and pays it back, he is entitled to a refund from the Government of the tax paid on it. *Greenwald* v. *United States*, 102 C. Cls. 272; *Gargaro* v. *United States*, 109 C. Cls. 528. Our reasons for so holding were stated at length in our opinions in those cases, and will not be repeated here. This case being in all essential respects like the two cases formerly decided, we decide it the same way.

15 The Government urges, as it did in the former cases, that the "claim of right" doctrine stated by the Supreme Court in *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, is a bar to recovery by the taxpayer in cases of this kind. We observe again that the Supreme Court language relied on by the Government was *obiter*. The taxpayer in the *American Oil* case received the money in 1917, and never paid it back. There were five years of litigation during which its right to the money was disputed, but it won the litigation and kept the money. The court's statement as to what would have been the result if the taxpayer had lost the litigation was, therefore, unnecessary to its decision. We are impressed by the recent observation of the Supreme Court in the case of *Commissioner* v. *Wilcox*, 327 U. S. 404, 408 that—

> For present purposes it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain.

The *Wilcox* case concerned the taxability of an embezzler upon the proceeds of his crime. His duty to repay would certainly not lose its quality of being "a definite, unconditional obligation" merely because at first he denied his crime and claimed that the money taken was his own, and persisted in that claim until he was convicted of the embezzlement. And the duty to repay of one civilly indebted because he had received money by mistake is no less "a definite, unconditional obligation" because he refuses to recognize the obligation until the contract in connection with which he mistakenly received the money has been interpreted and enforced by adjudication.

We think also that the Supreme Court's decision in *Freuler* v. *Helvering*, 291 U. S. 35, also subsequent to the *North American Oil* case, *supra*, has a bearing upon our question. In that case the beneficiaries of a trust had been paid the entire income of the trust in the taxable year, but later the State court having jurisdiction over the trust determined that the trustee should not have distributed the entire income, but should have withheld and retained for remaindermen a certain amount for depreciation. The State court
16 ordered the beneficiaries to repay the excess amounts to the trustee. They complied with this order, not by repaying the amounts, but by giving their non-interest bearing promissory notes to the presumptive remaindermen, payable at the time the remainders should vest in possession. The Supreme Court held that the beneficiaries were not taxable upon the amounts paid them in excess of what should have been paid them in the proper administration of the trust.

In the *Freuler* case the applicable statute was Section 219 (d) of the Revenue Act of 1921, which said:

> (d) In cases under paragraph (4) of subdivision (a) * * * the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not * * *.

The Supreme Court held that the State court's decree, made many years subsequent to the taxable year and the actual distribution of the income, was the "order governing the distribution" referred to in Section 219 (d) and that therefore only so much of the income actually distributed as was lawfully "distributable" in view of that subsequent order, was taxable to the beneficiaries. We recognize, of course, that the *Freuler* case involved a special section of the Revenue Act, which had its own wording. The use in that section of the

word "distributable" would seem to be accounted for by the fact that Congress intended to tax to beneficiaries money which was in fact available or owing to them by their trustees, even before it had actually been paid over to them. The fact that the court so interpreted the statute as to make taxability depend upon the outcome of litigation as to whether the beneficiaries actually receiving the income were legally entitled to keep it or not seems to us to discount very heavily the idea that the finances of the nation would be thrown into disorder if the Government were allowed to tax as income only that which is, in fact, income to the taxpayer, and not that which only seems to be income because he is mistaken as to his right to keep it. We remind, however, that in the instant case, as also in the *Greenwald* and *Gargaro* cases, *supra*, the taxpayer having received the income, paid his tax, and did not ask the
17 Government to wait for its revenue until he had completed his litigation or resolved his question otherwise. In all these cases the naked question has been whether the Government should keep money paid to it upon the mistaken assumption that the citizen had taxable income, when in truth he did not have the income, since he was under a legal obligation to return the money to his employer.

We are aware that the United States Court of Appeals for the Sixth Circuit has, upon similar facts, reached a contrary conclusion. *Haberkorn III* v. *United States*, 173 F. (2d) 587. We adhere, however, to the view expressed in our former decisions.

The plaintiff is entitled to recover $7,217.16 with interest according to law.

It is so ordered.

Howell, *Judge*; Littleton, *Judge*; and Jones, *Chief Judge*, concur.

WHITAKER, *Judge*, dissenting:

When this case was presented on oral argument I gained the impression, both from the statements of counsel for the plaintiff and for the defendant, that plaintiff and the company of which he was general manager had not acted under any misapprehension as to what were the facts governing their rights. I gained the impression that plaintiff had caused the company to pay him his bonus, based upon the company's profits before deduction of taxes, although he was fully aware that he was only entitled to a bonus on profits after deduction of taxes. But, apparently, I was mistaken.

The Commissioner of this court has found that when plaintiff directed the payment to himself of the bonus, computed on income before taxes, he believed that under his agreement with the company he was entitled thereto. Defendant took no exception to this finding.

Plaintiff's exception only accentuates the fact that plaintiff honestly believed that he was entitled to have it computed on this basis.

Plaintiff, after his discharge as manager, brought suit against his company for an additional amount to which he said he was entitled as a bonus under his agreement, and in his testimony in this suit he stated the agreement between him and the company was that his bonus should be computed on profits before taxes. The
18 Circuit Court for Cook County, Illinois, where the suit was brought, held that plaintiff had believed that he was entitled to a bonus computed on this basis, but that this belief was erroneous. This court has concurred in these findings.

This case, therefore, does not come within the rule of *Commissioner* v. *Wilcox*, 327 U. S. 404, where it was held that funds embezzled were not income to the embezzler, because he did not claim the funds as of right, thus distinguishing the case of *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417. In the case at bar this plaintiff, according to the findings, did honestly claim that he was entitled to the bonus paid him. He claimed it as of right.

Not coming within *Commissioner* v. *Wilcox*, *supra*, it would appear that the case comes within the rule laid down in the *North American Oil Consolidated* case, *supra*. In that case, and in numerous others, it was held that money received under a claim of right is income in the year received, although the recipient was mistaken in his claim of right, and later had to return the money. See, e. g., *Commissioner* v. *Alamitos Land Co.*, 112 F. (2d) 648; *Penn* v. *Robertson*, 115 F. (2d) 467; *National City Bank of New York* v. *Helvering*, 98 F. (2d) 93; *Saunders* v. *Commissioner*, 101 F. (2d) 407; *Haberkorn III* v. *United States*, 173 F. (2d) 587.

This court in a per curiam opinion in *Schramm* v. *United States*, 93 C. Cls. 181, adhered to this rule.

But it is said that in *Greenwald* v. *United States*, 102 C. Cls. 272, we held that money received under a mistake of fact was not income to the recipient, and that under this rule the excess bonus received by plaintiff was not income to him. In the case relied upon both the corporation and its officer were misled as to the corporation's income, due to falsification of the books by the company's auditor. Both parties were mistaken as to the fact of the amount of the company's income.

Here, plaintiff and the president of his company had a conversation in 1941 as to the basis for the computation of plaintiff's bonus. As a result of this conversation the president believed that the agreement was that plaintiff's bonus from then on would be computed on profits after taxes had been deducted. Plaintiff, however, was under a different impression, it seems. He thought the
19-20 agreement was not intended to apply indefinitely, but that the former agreement, that it should be computed on profits

before taxes had been deducted, would be restored at some later time, and that in 1944 he thought the year had arrived for this former agreement to be restored.

This falls far short of a mutual mistake of fact sufficient to set aside or reform a contract. Whatever mistake there may have been, it certainly was not mutual.

The situation was no different from that which gives rise to innumerable law suits: one party says the agreement was one thing, and the other party says it was another.

It seems impossible to me to bring this case within the decision in the *Greenwald* case, *supra*.

Nor can it be brought within the decision in *Gargaro* v. *United States*, 109 C. Cls. 528. The basis of that decision was that both parties thought the corporation's income was a certain amount, whereas it turned out to be a smaller amount. Here there was no mutual mistake of fact; instead there was a dispute as to what the facts were.

I am of opinion this case comes within the rule of the *North American Oil Consolidated* case, and does not come within any exception to that rule, nor, under the findings of fact, within any exception that should be made to that rule. Under the findings plaintiff claimed the income, honestly believing he was entitled to it, and he retained it, until, in a later year, he was forced by court order to return it. In such case he is liable for the taxes incident to it in the year received. See *Heiner* v. *Mellon*, 304 U. S. 271; *Burnet* v. *Sandford & Brooks Co.*, 282 U. S. 359; *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, 286-287.

I must respectfully dissent.

21-22 JUDGMENT OF THE COURT—July 10, 1950

Upon the special findings of fact, which are made a part of the judgment herein, the court concludes, as a matter of law, that plaintiff is entitled to recover.

IT IS THEREFORE ADJUDGED AND ORDERED that plaintiff recover of and from the United States seven thousand two hundred and seventeen dollars and sixteen cents ($7,217.16), with interest as provided by law.

23 Clerk's Certificate to foregoing transcript omitted in printing.

☆ U. S. GOVERNMENT PRINTING OFFICE 1950 910640 238

Supreme Court of the United States

No. 347, October Term, 1950

Order allowing certiorari

Filed December 11, 1950

The petition herein for a writ of certiorari to the United States Court of Claims is granted. The case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

923107—51

U. S. GOVERNMENT PRINTING OFFICE: 1951

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SUPREME COURT, U.S.

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No. 347

In the Supreme Court of the United States

OCTOBER TERM, 1950

UNITED STATES OF AMERICA, PETITIONER

v.

ELLIS R. LEWIS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Reasons for granting the writ	6
Conclusion	11

CITATIONS

Cases:

Akers v. *Scofield*, 167 F. 2d 718, certiorari denied, 335 U. S. 823	10
Barker v. *Magruder*, 95 F. 2d 122	7
Board v. *Commissioner*, 51 F. 2d 73, certiorari denied, 284 U. S. 658	7
Brown v. *Helvering*, 291 U. S. 193	10
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	10
Chicago, R. I. & P. Ry. Co. v. *Commissioner*, 47 F. 2d 990, certiorari denied, 284 U. S. 618	7
Commissioner v. *Alamitos Land Co.*, 112 F. 2d 648, certiorari denied, 311 U. S. 679	7
Commissioner v. *Wilcox*, 327 U. S. 404	9
Gargaro v. *United States*, 109 C. Cls. 528, 114 C. Cls. 704	9, 11
Greenwald v. *United States*, 102 C. Cls. 272	9, 11
Griffin v. *Smith*, 101 F. 2d 348	7
Haberkorn v. *United States*, 173 F. 2d 587	11
Heiner v. *Mellon*, 304 U. S. 271	10
National City Bank of New York v. *Helvering*, 98 F. 2d 93	10
North American Oil v. *Burnet*, 286 U. S. 417	7, 8, 10
Penn v. *Robertson*, 115 F. 2d 167	7
Saunders v. *Commissioner*, 101 F. 2d 407	7
Schramm v. *United States*, 93 C. Cls. 181	8
United States v. *Commerford*, 64 F. 2d 28, certiorari denied, 289 U. S. 759	7

Statute:

Internal Revenue Code, Sec. 22 (26 U.S.C. 1946 ed., Sec. 22)	2

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 347

UNITED STATES OF AMERICA, PETITIONER

v.

ELLIS R. LEWIS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Claims entered in this case.

OPINION BELOW

The special findings of fact, conclusions of law, and opinion of the Court of Claims (R. 5-11) together with the dissenting opinion of Judge Whitaker (R. 11-13) are not yet reported.

JURISDICTION

The judgment of the Court of Claims was entered on July 10, 1950. (R. 13.) The jurisdiction of

this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

During the year 1944, respondent received from his employer compensation consisting of salary and bonus. However, pursuant to a court judgment in the year 1946, he was obliged to return a portion of the bonus to the employer. Was the amount thus returned to the employer properly included in respondent's taxable income for the year 1944?

STATUTE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

STATEMENT

During the year 1944 and for some years prior thereto, taxpayer (respondent) was vice president, a member of the board of directors and general manager of the Accurate Spring Manufacturing Company. In 1944 he directed the policies of the company and was in active charge of its entire operations, including the hiring and discharging of employees, execution of contracts, and signing of checks together with the bookkeeper and assistant treasurer of the company. During that year the president of the company was in Florida and did not participate substantially in the management of the business. (R. 5-6.)

In December 1938, it was agreed between the taxpayer and the president that, in addition to a stated salary, taxpayer would receive a bonus of ten per cent of the net profits of the company before deduction for taxes. For the years 1939 and 1940 taxpayer was paid on that basis. Late in 1941 the president discussed with the taxpayer the matter of the latter's bonus because of the large amount of compensation he would receive on the existing basis due to the substantial increase in the company's profits. It was decided at that time, however, that no change would be made until after the profits for 1941 had been determined. (R. 6.)

In the early part of 1942, after the profits for 1941 had been determined, the taxpayer was presented with a statement based on computations of

the bonus both before and after deduction for taxes. Taxpayer agreed to accept for that year a bonus computed after deduction for taxes, and his compensation for 1941 was paid on that basis. Without further agreement between the parties, taxpayer's compensation for the years 1942 and 1943 was similarly paid on the same basis. (R. 6.)

For the year 1944, and without further discussion or agreement as to the basis of his compensation, taxpayer directed the payment to himself of a bonus on the basis of a computation on profits *before* deduction for taxes. On this basis taxpayer received a bonus of $21,924. At that time taxpayer believed that he was entitled to have his bonus computed on that basis, notwithstanding the acceptance by him of the bonuses for 1941, 1942 and 1943 on the basis of profits after deduction for taxes. (R. 6.)

The company in its income tax return for 1944, filed March 1945, deducted as part of the compensation paid to officers the sum of $21,924 paid to taxpayer and paid its income tax accordingly. Later, in 1945, the company filed an amended return in which it deducted as bonus compensation to taxpayer only the sum of $11,067.94 and paid the additional tax resulting from the recomputation. (R. 6.)

Some time after the company's return for 1944 had been filed, taxpayer was discharged from his position, and he subsequently brought suit in an

Illinois state court against the company for additional compensation for the year 1944, claiming among other things that by reason of improper deductions of expense items the profits before taxes were stated too low and that he should have received a larger bonus for that year. The company filed a counterclaim in which it claimed that the taxpayer had acted improperly in directing payment to himself of a bonus computed on profits before taxes for the year 1944, and that by such improper action he had received an excessive bonus. At the trial the taxpayer testified that the agreement was to pay a bonus based on profits before taxes. (6-7, 8-9.)

On December 3, 1946, judgment was entered against taxpayer. The court found that under the agreement between taxpayer and the company the taxpayer was entitled to receive for the year 1944 a bonus computed on the profits of the company after deduction for taxes, notwithstanding that taxpayer mistakenly believed that the bonus was to have been computed on the net profits before deduction for taxes. The court found that by virtue of this mistake taxpayer had received for the year 1944 the sum of $10,856.06 in excess of the amount to which he was entitled. Taxpayer repaid that amount to the company in 1946. (R. 7.)

On or about March 15, 1945, and November 7, 1945, respectively, the taxpayer filed original and amended income tax returns for the calendar year

1944, and duly paid the total tax of $18,098.99 disclosed therein. (R. 7.) Included in the taxable income shown on taxpayer's amended return was the $21,924 received as a bonus from the company based upon a percentage of the net profits before taxes. (R. 7.)

Later, taxpayer filed with the appropriate Collector of Internal Revenue a timely claim for refund for the year 1944, basing such claim upon the exclusion from his taxable net income, as reported, of the sum of $10,856.06 which the state court had decreed was improperly paid to taxpayer by the company. (R. 7.) After rejection of the claim by the Commissioner (R. 7), proceedings were instituted in the Court of Claims to recover the refund sought (R. 1-4.) The Court of Claims entered judgment for the taxpayer. (R. 13.)

REASONS FOR GRANTING THE WRIT

This case presents the familiar situation where a taxpayer receives income in a given year and pays the appropriate tax thereon, but in a subsequent year, because of unforseen contingencies, he is obliged to restore a portion of such income to the payor. This poses the question as to whether the income should be adjusted in the year of receipt or in the year in which restitution is made.

1. The decision below is wrong. The court, Judge Whitaker dissenting, erroneously held "that when a taxpayer receives money which he supposes

he is entitled to keep, and pays income tax on it, but later learns that he was mistaken in thinking he was entitled to keep it, and pays it back, he is entitled to a refund from the Government of the tax paid on it." (R. 9.) There is no basis in the income tax law or the decided cases to support such a holding.

In *North American Oil* v. *Burnet*, 286 U. S. 417, this Court specifically stated that (p. 424):

> If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.

This rule, which has come to be known as the "claim of right" doctrine, has been followed by lower federal courts in many cases, including *Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9), certiorari denied, 311 U. S. 679; *Penn* v. *Robertson*, 115 F. 2d 167 (C. A. 4); *Saunders* v. *Commissioner*, 101 F. 2d 407 (C. A. 10); *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7); *Board* v. *Commissioner*, 51 F. 2d 73 (C. A. 6), certiorari denied, 284 U. S. 658; *United States* v. *Commerford*, 64 F. 2d 28 (C. A. 2), certiorari denied, 289 U. S. 759; *Barker* v. *Magruder*, 95 F. 2d 122 (C. A. D. C.); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. 2d 990 (C. A. 7), certiorari denied, 284 U. S. 618.

The Court of Claims applied the doctrine in a *per curiam* opinion in *Schramm* v. *United States*, 93 C. Cls. 181.

There is no essential difference between the present case and those above cited. In each instance the taxpayer received income under a claim of right and without restriction as to its disposition or use. Here the taxpayer believed at the time that he was entitled to receive the bonus paid to him in 1944, and the court below so found. (R. 7.) Furthermore, after the taxpayer was discharged from his position in 1945, he instituted suit in an Illinois court against his former employer claiming that he was entitled to an even larger amount of bonus for the year 1944. A counterclaim by the company based on the assertion that the bonus paid to the taxpayer in 1944 was excessive (R. 6-7, 8-9) was sustained by the court and then, for the first time, the obligation to repay the excess compensation arose. At the trial and at all times prior to the judgment of the Illinois court, the taxpayer insisted that he was entitled to the bonus originally paid him in 1944. (R. 8-9.) Under the rule of *North American Oil* and the cases following it, the bonus received by taxpayer in 1944 was properly taxed to him in that year. Accordingly, the decision of the Court of Claims in the instant case violates a well-established doctrine of federal tax law, and, as the Court of Claims itself recognizes (R. 14), creates a clear conflict of decisions among the lower federal courts.

The deviation by the Court of Claims from the so-called "claim of right" doctrine had its inception in *Greenwald* v. *United States*, 102 C. Cls. 272, where the court concluded that because a bonus received by the taxpayer was based upon an improper computation of net income which resulted in the payment of a bonus in excess of that to which he was entitled, the doctrine should not be applied. In a later case, *Gargaro* v. *United States*, which was first decided on demurrer (109 C. Cls. 528) and later on the merits (114 C. Cls. 704), the net income of the corporation which paid the bonus was reduced in a subsequent year by reason of renegotiation proceedings. The court again held for the taxpayer.

In its opinion in the present case (R. 9-10), the Court of Claims erroneously relied upon *Commissioner* v. *Wilcox*, 327 U. S. 404, to support its holding. The *Wilcox* case, however, involved the tax liability of an embezzler and in determining that the amount embezzled was not income for tax purposes, this Court stressed the fact that the embezzler had not received the money under a claim of legal right and was at all times under the undenied obligation to restore it to its rightful owner. Obviously, that case merely holds, on the facts there presented, that the "claim of right" doctrine was inapplicable. It not only does not support the holding below, but indeed provides further proof of this Court's acceptance of the "claim of right"

doctrine. Compare *Akers* v. *Scofield*, 167 F. 2d 718 (C. A. 5), certiorari denied, 335 U. S. 823, which involved a "gold brick" swindler. The court determined that the amount received as a result of the swindle was taxable because it had been received by the taxpayer as his own under a claim of right and without any restriction upon its disposition or use.

2. An issue of considerable importance in the administration of the income tax law is thus presented in the instant case. The "claim of right" doctrine established in the *North American Oil* case, *supra*, is merely an application of a fundamental principle of tax law, namely, that tax accounting must be on an annual basis because of the practical necessity for determining revenues on such basis. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Heiner* v. *Mellon*, 304 U. S. 271; *Brown* v. *Helvering*, 291 U. S. 193, 199; *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C. A. 2). If the contrary doctrine laid down by the Court of Claims should be permitted to stand, a taxpayer could withhold the payment of taxes on income for an indefinite period in order to await final determination, whenever in the future it should come, whether such income really is his and can without question be retained by him. Clearly, such a proposition would, if accepted, wreak havoc with the revenue.

3. As has already been mentioned, the decision below is in conflict with numerous decisions of this

Court and of lower federal courts throughout the country. It is also in express conflict with a recent case, *Haberkorn* v. *United States,* 173 F. 2d 587 (C. A. 6), which was decided March 28, 1949, subsequent to the decision by the Court of Claims in *Gargaro* v. *United States, supra.* In applying the "claim of right" doctrine in the *Haberkorn* case, the court expressed disagreement with the decisions of the Court of Claims in the *Greenwald* and *Gargaro* cases, *supra.* And, in its opinion in the instant case, the Court of Claims referring to the *Haberkorn* decision, stated that it was "aware that * * * the Sixth Circuit has, upon similar facts, reached a contrary conclusion." R. 11.)

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

OCTOBER, 1950.

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No. 347

In the Supreme Court of the United States

OCTOBER TERM, 1950

UNITED STATES OF AMERICA, PETITIONER

v.

ELLIS R. LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

Opinion below
Jurisdiction
Question presented
Statutes involved
Statement
Specification of errors t
Summary of argument
Argument: The entire
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to which he believed
his taxable income
obliged, pursuant to
tion of the bonus to h
Conclusion

Cases:

Agne v. *United Sta*
Akers v. *Scofield*,
823
Anderson v. *Bowe*
U. S. 918
Barker v. *Magrude*
Blum v. *Helvering*,
732
Board v. *Commiss*
U. S. 658
Boehm v. *Commis*
Boston Consol. Gas
Brown v. *Helvering*
Buder v. *United S*
amended, April
Burnet v. *Sanford*
Burnet v. *Thompso*
Caldwell v. *Commi*
Capital Warehouse
Chi. R. I. & P. R
tiorari denied, 2

INDEX

	Page
	1
	1
	2
	2
	3
e urged	8
	9
m received by taxpayer during 1944 onus, claimed by him at that time and was entitled, was properly included in that year, although in 1946 he was state court judgment, to return a por- employer	14
	42

CITATIONS

, 42 F. Supp. 66	25, 26, 33
F. 2d 718, certiorari denied, 335 U. S.	23, 24, 29
170 F. 2d 676, certiorari denied, 337	24, 29, 33, 34
95 F. 2d 122	24, 28, 33
4 F. 2d 482, certiorari denied, 295 U. S.	28
ner, 51 F. 2d 73, certiorari denied, 284	25
ner, 326 U. S. 287	36
. v. *Commissioner*, 128 F. 2d 473	24, 28, 33
91 U. S. 193	17, 19
tes, decided May 17, 1940, judgment 1941, appeal dismissed, 116 F. 2d 284	30
Brooks Co., 282 U. S. 359	10, 15, 16, 17, 36
Oil & Gas Co., 283 U. S. 301	17
oner, 135 F. 2d 488	28, 33
. v. *Commissioner*, 171 F. 2d 395	29, 30
Co. v. *Commissioner*, 47 F. 2d 990, cer- U. S. 618	27

Cases—Continued

	Page
Clay Sewer Pipe Ass'n v. *Commissioner*, 139 F. 2d 130	24, 29
Commissioner v. *Alamitos Land Co.*, 112 F. 2d 648, certiorari denied, 311 U. S. 679	24, 26, 31, 32
Commissioner v. *Batten, Barton, Durstine & Osborn* 171 F. 2d 474, certiorari denied, 338 U. S. 816	35
Commissioner v. *Lyon*, 97 F. 2d 70	28
Commissioner v. *Switlik*, 184 F. 2d 299	27, 31, 33
Commissioner v. *Turney*, 82 F. 2d 661	30
Commissioner v. *Wilcox*, 327 U. S. 404	21, 22, 30
Currier v. *United States*, 166 F. 2d 346	23
De Guire v. *Higgins*, 159 F. 2d 921	29
Detroit Consolidated Theatres v. *Commissioner*, 133 F 2d 200	28
Downing v. *Commissioner*, 43 B. T. A. 1147	27, 31
Fairmount Creamery Corp. v. *Helvering*, 89 F. 2d 810	28
First Nat. Bank v. *Commissioner*, 107 F. 2d 141	28
Fleischer v. *Commissioner*, 158 F. 2d 42	22, 27, 30, 31, 33
Ford v. *Commissioner*, 51 F. 2d 206	30
Ford v. *Nauts*, 25 F. 2d 1015	30
Freuler v. *Helvering*, 291 U. S. 35	23, 24, 35
Gargaro v. *United States*, 73 F. Supp. 973, 86 F. Supp. 840	18, 22, 25
General Outdoor Advertising Co. v. *Helvering*, 89 F. 2d 8[illegible]	24
Gilken Corp. v. *Commissioner*, 176 F. 2d 141	29
Greenfeld v. *Commissioner*, 165 F. 2d 318	23
Greenwald v. *United States*, 57 F. Supp. 569	11, 24, 25, 31
Griffin v. *Smith*, 101 F. 2d 348, certiorari denied, 308 U. S. 561	24, 26, 31, 32
Guarantee Trust Co. v. *Commissioner*, 303 U. S. 493	17
Haberkorn v. *United States*, 173 F. 2d 587	23, 24, 25, 29, 30, 31, 33
Heiner v. *Mellon*, 304 U. S. 271	20
Helvering v. *Clifford*, 309 U. S. 331	35
Helvering v. *Midland Ins. Co.*, 300 U. S. 216	35
Jacobs v. *Hoey*, 136 F. 2d 954, certiorari denied, 320 U. S. 790	28, 33
Knight Newspapers v. *Commissioner*, 143 F. 2d 1007	30
Lucas v. *Ox Fibre Brush Co.*, 281 U. S. 115	17
Manning v. *Seeley Tube & Box Co.*, 338 U. S. 561	38, 39, 41
McDuffie v. *United States*, 19 F. Supp. 239	25, 27, 33
Moore v. *Thomas*, 131 F. 2d 611	27, 30, 33
National City Bank of New York v. *Helvering*, 98 F. 2d 93	26, 31, 36
North American Oil v. *Burnet*, 286 U. S. 417	10, 17, 18, 22, 32
O'Meara v. *Commissioner*, 8 T. C. 622	33, 41
Penn v. *Robertson*, 115 F. 2d 167	26, 31, 33
Rodgers v. *United States*, 332 U. S. 371	39
St. Regis Paper Co. v. *Higgins*, 157 F. 2d 884, certiorari denied, 330 U. S. 843	22, 24, 27, 30, 33

Cases—Continued

	Page
Saunders v. *Commissioner*, 101 F. 2d 407	24, 26, 31, 33
Schramm v. *United States*, 36 F. Supp. 1021	25, 26, 31, 33
Security Mills Co. v. *Commissioner*, 321 U. S. 281	20, 31, 35
Thomas v. *United States*, 22 F. Supp. 412	25, 26, 33
Wells v. *United States*, 64 F. Supp. 476	25
Woolford Realty Co. v. *Rose*, 286 U. S. 318	17
Statutes:	
Internal Revenue Code:	
Sec. 22 (26 U. S. C. 1946 ed., Sec. 22)	2, 11, 35
Sec. 41 (26 U. S. C. 1946 ed., Sec. 41)	2, 16
Sec. 42 (26 U. S. C. 1946 ed., Sec. 42)	3, 16
Sec. 43 (26 U. S. C. 1946 ed., Sec. 43)	35
Sec. 44 (26 U. S. C. 1946 ed., Sec. 44)	35
Sec. 122 (26 U. S. C. 1946 ed., Sec. 122)	35, 41
Sec. 127 (26 U. S. C. 1946 ed., Sec. 127)	35
Sec. 128 (26 U. S. C. 1946 ed., Sec. 128)	35
Sec. 162 (26 U. S. C. 1946 ed., Sec. 162)	35
Sec. 322 (26 U. S. C. 1946 ed., Sec. 322)	39
Sec. 3806 (26 U. S. C. 1946 ed., Sec. 3806)	35
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 219	35
Miscellaneous:	
G. C. M. 16730, XV-1 Cum. Bull. 179 (1936)	33

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ELLIS R. LEWIS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The special findings of fact and opinion of the Court of Claims (R. 4–11), together with the dissenting opinion of Judge Whitaker (R. 11–13), are reported at 91 F. Supp. 1017.

JURISDICTION

The judgment of the Court of Claims was entered on July 10, 1950 (R. 13). A petition for a writ of certiorari was filed on October 6, 1950, and was granted on December 11, 1950 (R. 14). The jurisdiction of this Court rests on 28 U. S. C., Section 1255 (1).

QUESTION PRESENTED

During the year 1944, taxpayer received from his employer compensation consisting of salary and bonus, to which at that time he made claim and believed he was entitled. However, pursuant to a court judgment in the year 1946, he was obligated to return a portion of the bonus to the employer. Was the amount thus returned to the employer properly included in taxpayer's taxable income for the year 1944?

STATUTES INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (*a*) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

> SEC. 41. GENERAL RULE.
>
> The net income shall be computed upon the basis of the taxpayer's annual account-

ing period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26. U. S. C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687.] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 42.)

STATEMENT

There is no dispute as to the relevant facts. The following is a summary of the special findings of fact made by the Court of Claims (R. 4–7):

During the entire calendar year 1944, and for some years prior thereto, taxpayer was vice-president, a member of the board of directors, and general manager of Accurate Spring Manufacturing Company (R. 5) (referred to herein as the "company"). During 1944, he was in active charge of the entire operation of the company, and, among other things, he did all the hiring and discharging, executed all the contracts, signed checks together with the individual who was the bookkeeper and assistant treasurer of the company, and directed the policies of the company. The president of the company, Frank B. Weber, was in Florida during the year 1944, and at no time during that year participated in the conduct of the business of the company except for one or two telephone conversations with taxpayer and one or two meetings with taxpayer, once in New York City and once in Ashland, North Carolina. (R. 5–6.)

Taxpayer had been selected by the president of the company in December 1938, to be its general manager effective January 1, 1939. It was then agreed between taxpayer and the president that, in addition to a stated salary, taxpayer was to receive a bonus of 10 percent of the net profits of the company before deduction for taxes. Taxpayer was paid on that basis for the years 1939 and 1940. At some time late in 1941 the president and taxpayer discussed the matter of taxpayer's bonus and the amount of compensation

which, due to the large increase in the company's profits from increased business, he would receive on the existing basis. However, it was decided that no change would be made until after the profits for 1941 had been determined. (R. 6.)

Subsequently, after the 1941 profits had been determined, and early in 1942, taxpayer was presented with a statement showing the bonuses to be paid him, based on computations of the bonus both before and after deduction for taxes. Taxpayer agreed to accept for 1941 the bonus computed after deduction for taxes, and he was paid on that basis for that year. Without further agreement between taxpayer and the president of the company, the compensation for the years 1942 and 1943 was likewise paid on the basis of the computation after deduction for taxes. (R. 6.)

For the year 1944, without further agreement between taxpayer and the company, taxpayer directed payment to himself of a bonus on the basis of a computation on profits before deduction for taxes. On this basis, the bonus paid to taxpayer was $21,924. At the time, taxpayer believed this calculation to be in accord with the agreement upon which he was entitled to have his bonus computed, notwithstanding his acceptance of the bonus for 1941, 1942, and 1943 on the basis of a computation after deduction for taxes. (R. 6.)

In its income tax return for 1944, filed in March 1945, the company deducted as a part of

the compensation paid to officers the sum of $21,924, as paid to taxpayer, and the company's tax was accordingly computed and paid. Later in 1945, the company filed an amended return, in which it deducted as bonus compensation to taxpayer the sum of $11,067.94, instead of $21,924 deducted in its original return. The additional tax based on the recomputation was paid by the company. (R. 6.)

Some time after the company's return for 1944 had been filed, taxpayer was discharged from his position with the company. Following his discharge, taxpayer brought suit against the company in the Circuit Court of Cook County, Illinois, claiming, among other things, that by reason of deductions of improper items as expense, the profits before taxes were stated too low and that a larger bonus should have been paid to him for 1944. The company filed a counterclaim, claiming, among other things, improper action on the part of taxpayer in directing payment to himself of a bonus computed on the profits before taxes, and that thereby taxpayer received as a bonus $21,924, instead of $11,067.94, which was the correct amount computed after deduction for taxes. (R. 6–7.)

At the trial in the state court, taxpayer testified that the agreement was to pay a bonus based on profits before taxes (R. 7). The state court found that the agreement for 1944 was that the bonus should be computed on the profits after

deduction for taxes, that taxpayer erroneously and mistakenly believed and understood that the bonus was to be computed before deduction of taxes, and that by virtue of this mistake taxpayer received for the year 1944 the sum of $10,856.06 in excess of the amount to which he was entitled under the agreement as found by the court. Judgment was entered for the company, on December 3, 1946 (as of November 15, 1946), in an amount which included the indicated excess of the bonus payment. (R. 7.)

Taxpayer's taxable income for 1944, as shown on his amended return for that year, filed on November 7, 1945, was $40,177.62, and this sum included the amount of $21,294 as taxpayer's bonus from the company for the year 1944, based upon a percentage of the net profits. He paid tax in the amount of $18,098.99, and $71.34 as interest for a partial late payment. (R. 7.)[1]

Excluding from his taxable income the amount of $10,856.06, which the state court decreed was improperly paid to taxpayer, and which he repaid

---

[1] Taxpayer had originally filed an income tax return for the calendar year 1944, on or shortly prior to March 15, 1945, disclosing taxable income of $37,472.30 and a tax of $16,259.37, which was timely paid. Subsequently, on November 7, 1945, he filed an amended return for 1944, showing taxable income of $40,177.62 and a total tax of $18,098.99. With the amended return, taxpayer paid $1,839.62, the balance due after allowing credit for $16,259.37 previously paid pursuant to the original 1944 return. Because of late payment of this amount of $1,839.62, the Collector assessed $71.34 as interest, which taxpayer paid on October 18, 1946. (R. 5.)

to the company in 1946, taxpayer's taxable income for 1944 would be $29,321.56, and his tax on his 1944 income would be $10,953.17—that is, $7,145.82 less than the tax which he had paid, not including $71.34 interest which he had also paid because of the late payment of the tax. (See fn. 1, *supra,* p. 7.) The sum of these two amounts is $7,217.16. (R. 7.)

On March 25, 1947, taxpayer filed with the Collector of Internal Revenue at Chicago, Illinois, a claim for refund of income taxes for the calendar year 1944, and interest and penalty on part thereof, in the aggregate amount of $7,217.16, based on the circumstances above set forth. Subsequently, on or about October 3, 1948, taxpayer received a notice from the Commissioner of Internal Revenue, dated September 28, 1948, advising him of the disallowance in full of this refund claim. (R. 7.)

Suit against the United States in the court below was filed October 29, 1948 (R. 1), and resulted in the judgment under review in favor of taxpayer in the amount claimed, namely, $7,217.16, with interest (R. 13). Judge Whitaker dissented (R. 11–13).

SPECIFICATION OF ERRORS TO BE URGED

The Court of Claims erred:

1. In holding that taxpayer's receipt in 1944 of that part of the bonus, the equivalent of which he later refunded to his employer pursuant to an

adverse state court judgment, did not constitute taxable income for the year 1944.

2. In holding that the receipt of such sum by taxpayer under *bona fide* claim of right, and without restriction as to its disposition, even though his right to such receipt was later contested, did not constitute taxable income for the year 1944.

3. In failing to hold that the United States was entitled to retain the income tax on such receipt for 1944, in the amount of $7,217.16.

4. In holding that taxpayer is entitled to refund of such tax and to recover from the United States $7.217.16 with interest, and in granting judgment in favor of taxpayer and against the United States.

SUMMARY OF ARGUMENT

The entire sum received by taxpayer during 1944 by way of bonus, claimed by him at that time, to which he believed he was entitled, and which he unrestrictedly used, was properly included in his taxable income in that year, although subsequently, in 1946, he was obliged, pursuant to a state court judgment, to return a portion of the bonus to his employer.

A. Since the imposition of a tax upon income requires that points of time be fixed between which the income is to be measured for tax purposes, Sections 41 and 42 of the Internal Revenue Code prescribe that net income shall be computed

upon the basis of taxpayer's annual accounting period and that the amount of all items of gross income shall be included for the taxable year in which received by taxpayer. This rule of annual accounting is essential in order to "produce revenue ascertainable, and payable to the government, at regular intervals," as well as "to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation." *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365.

B. The controlling ruling in *North American Oil* v. *Burnet*, 286 U. S. 417, 424, follows as a necessary corollary. The Court there held that "if a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent." The court below, however, renounces these well settled principles and would substitute for them a different system, by which the tax is assessed wholly or in part on the basis of the finally ascertained results of particular transactions. Similar efforts have been consistently repudiated by this Court over a period of more than twenty years.

C. In the years intervening since 1932, the *North American Oil* case, and the "claim of right" doctrine there enunciated, have also been

repeatedly applied in a multitude of cases by the courts of appeals of every circuit, without exception. Moreover, before deviating from it in *Greenwald* v. *United States,* 57 F. Supp. 569 (1944), the Court of Claims itself four times followed and correctly applied the principle. The courts have held earnings or gain taxable in the year of receipt (1) even though, as here, the taxpayer's right to the money is subject to dispute, and liability to restore its equivalent may be, or is being, asserted, or (2) even though the income is subject to an obligation to restore which is admitted or uncontroverted, but, at the same time, contingent or indefinite. It has made no difference in result, moreover, that the taxpayer has been required to repay the equivalent in a subsequent year, as was the present taxpayer, nor that he voluntarily paid the tax on the original receipt, and after making the repayment sought a tax refund. For the corollary of the *North American* rule is that, in the event of repayment, taxpayer is allowed a deduction from the profits of the refund year.

D. There is no reason or occasion for the Court to change these settled rules. The "claim of right" doctrine has achieved an established status which should be changed, if at all, only by Congress, and there is nothing in the present legislation indicating that Congress has such a purpose or desire. Under the sweeping language of Section 22 (a) of the Internal Revenue Code, Congress intends to include in gross income everything which in

fact is income derived from any source whatever, and the provisions for annual accounting show that each taxable year is to be considered as a unit. Wherever it has desired to make exceptions to these rules, Congress has done so in express and carefully limited terms. The issue here is, essentially, in which year shall the balancing deduction be taken—the year of receipt or the year of refund. This is a subject for legislative choice, and Congress has thus far chosen the former.

Moreover, there are good reasons for retaining the "claim of right" doctrine. The Government should be able to exact prompt collection of taxes without being compelled to take sides in, or await the outcome of, private controversies. The taxpayer has unrestricted use of the gain, can pay the tax out of its proceeds, and is treated on a par with other taxpayers receiving income in that year. In addition, since the issue whether a particular item is includible in taxable income of the year of receipt cannot turn on the taxpayer's choice to pay the tax and then seek a refund or to await a deficiency assessment, the decision below tends to foster delay in payment and speculation on the part of the irresponsible and unscrupulous at the expense of the Government and the general body of law-abiding taxpayers; and it does so with respect to taxes on profits which, by hypothesis, the taxpayer unrestrictedly uses throughout and claims as rightfully his.

Eventual collection of the tax is also imperiled, since in the subsequent year of settlement of the controversy taxpayer may no longer be in possession of the means with which to satisfy the tax.

Other difficulties would also ensue if the decision below were allowed to stand. On the theory of the court below, in a case where taxpayer had not repaid the income until after expiration of the time limitation for filing refund claims, he would be remediless, since the ground of the holding is that the original receipt of money is not to be regarded as income in the taxable year, and therefore tax effect could be given to the repayment only in that barred year. Similarly, a taxpayer might support a claim for tax refund, even though, for example, he had never satisfied a state court judgment compelling repayment, on the theory that the order for repayment automatically transformed the gain previously received into non-income. These awkward and discriminatory consequences necessarily flow from the premises of the Court of Claims opinion. They cannot properly be cured by some such device as allowing the taxpayer the option of seeking a readjustment in the year of original receipt or of claiming a deduction in the year of repayment. That hybrid rule would discriminate against the revenue by permitting the taxpayer to select the most advantageous tax treat-

ment, and give the Government no compensating advantage. In any event, such a novel rule may not appropriately be made by the courts, but would require legislative intervention.

On the other hand, the annual system of computation, which Congress has elected and to which it has consistently adhered since the inception of the income tax, affords equity in general and, by virtue of the deduction allowed in the repayment year, works no particular injustice in this class of case. The uniform result of the established system has been denial both to the Government and to taxpayers of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment. The difficulties implicit in the decision below demonstrate the fairness and practicality of the present rule, as well as the intrinsic legislative character of any change, such as that attempted by the court below.

ARGUMENT

THE ENTIRE SUM RECEIVED BY TAXPAYER DURING 1944 BY WAY OF SALARY AND BONUS, CLAIMED BY HIM AT THAT TIME AND TO WHICH HE BELIEVED HE WAS ENTITLED, WAS PROPERLY INCLUDED IN HIS TAXABLE INCOME IN THAT YEAR, ALTHOUGH IN 1946 HE WAS OBLIGED, PURSUANT TO A STATE COURT JUDGMENT, TO RETURN A PORTION OF THE BONUS TO HIS EMPLOYER

The entire bonus in controversy was received by taxpayer in 1944, received under claim and *bona fide* belief that it was his, as of right (R. 6). He gained title to, and unrestricted use of, the

money in that year, and claimed and treated it as his own. Indeed, in the succeeding year (1945), he insisted that he was entitled to an even larger amount from his former employer for 1944 bonus, and instituted suit in an Illinois court in enforcement of this claim. In that suit, the company counterclaimed that the bonus paid to taxpayer in 1944 was excessive (R. 6–7, 8–9). But, at the trial, taxpayer continued to maintain and, indeed, swore, that he was entitled to the entire amount paid him in 1944 (R. 7, 12). Only when forced by the adverse judgment of the state court, did taxpayer in 1946—two years after its receipt—pay to the company the sum of $10,856, representing the equivalent of that part of the bonus found by the state court to be excessive (R. 7, 9, 12–13). These are the undisputed facts upon which it must be determined whether or not the bonus constituted income to taxpayer in 1944.

A. Since income is by nature a flow, rather than a static condition or object, the imposition of a tax upon income requires that points of time be fixed between which the income is to be measured for tax purposes. Hence, as this Court said, in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 363:

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period,

> either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt.

Thus, Section 41 of the Internal Revenue Code, *supra*, pp. 2–3, prescribes that "The net income shall be computed upon the basis of the taxpayer's *annual* accounting period" [italics supplied], and Section 42, *supra* (p. 3), entitled "Period In Which Items Of Gross Income Included", requires that "The amount of all items of gross income shall be included in the gross income *for the taxable year in which received* by the taxpayer" [italics supplied].

Indeed, as this Court further explained in the *Sanford & Brooks* case, a rule of annual accounting is requisite, as a general matter, both to assure the Government regular and ascertainable production of revenue and a system susceptible of practicable operation (p. 365):

> The Sixteenth Amendment was adopted to enable the government to raise revenue by taxation. It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation.

If, instead of this system of annual accounting, a basis of finally ascertained results of particular transactions is to be substituted, Congress and not

the courts must provide it. *Burnet* v. *Sanford & Brooks Co., supra*, at 387.

This general principle of annual accounting has been consistently applied by this Court, absent a specific statutory provision to the contrary, to a number of varying circumstances. *E. g. Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115, 120 (corporation may deduct bonuses paid to officers in taxable year though services were largely rendered in previous years); *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301, 306 (taxpayer cannot deduct from income for taxable year "depreciation, depletion, business losses or other similar items attributable to other years"); *Woolford Realty Co.* v. *Rose*, 286 U. S. 318, 326 (no deduction of losses suffered in earlier years); *Brown* v. *Helvering*, 291 U. S. 193 (contingent liability not actually incurred in taxable year may not be deducted as expense paid or incurred); *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493, 498 (decedent partner's estate taxable on all income received during taxable year, including that earned after end of partnership's fiscal year, and not simply on income earned during partnership's year).

B. This Court's ruling in *North American Oil* v. *Burnet*, 286 U. S. 417, announcing the "claim of right" doctrine which is controlling here, is another corollary of the general principles expounded in the *Sanford & Brooks* case. In the *North American* case, the Court held income tax-

able in the year of receipt (1917), even though the litigation on which the right to the money depended was still in process and was not decided until 1922. In oft-followed language, Mr. Justice Brandeis said for the Court (p. 424):

> The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. See *Board* v. *Commissioner,* 51 F. 2d 73, 75, 76. Compare *United States* v. *S. S. White Dental Mfg. Co.,* 274 U. S. 398, 403. If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. Compare *Lucas* v. *American Code Co., supra.*

Contrary to the statement of the majority of the Court of Claims in the opinion below (R. 9), and in *Gargaro* v. *United States,* 73 F. Supp. 973, 975, this expression of the Court was neces-

sary to its decision and was not dictum. The question posed and decided was whether the profits were income in 1917, the year of receipt under claim of right, even though subject to an outstanding contingent liability which might entail future restoration of the equivalent, or whether the profits were income in 1922, the year in which the outstanding adverse claim against the earning was finally disposed of by conclusion of the litigation in taxpayer's favor. The holding was that the contingent liability to refund did not affect its quality as income in the earlier year of receipt. See *Brown* v. *Helvering,* 291 U. S. 193, 199, *infra.* Thus, whether, in fact, the money was or was not later refunded was irrelevant to the issue presented and decided.

Moreover, in succeeding decisions, the Court has afforded repeated confirmation to the principle of the *North American* case. Thus, the quality of a receipt, as income, is not affected by the circumstance that part may have to be refunded in some future year, in the event a contingent obligation, subject to which the payment was received, becomes absolute. So this Court, referring to the *North American Oil case,* held in *Brown* v. *Helvering,* 291 U. S. 193, 199:

> When received, the * * * right to it was absolute. It was under no restriction, contractual or otherwise, as to its disposition, use or enjoyment.

Nor is it of any significance that until completion it cannot be known whether a business venture as a whole has been profitable, for (*Heiner* v. *Mellon,* 304 U. S. 271, 275)—

> Under that law [the Federal income tax system] the question whether taxable profits have been made is determined annually by the result of the operations of the year

and "the tax on a year's income may not be withheld because losses may thereafter occur" (p. 276).

In *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, the receipt by taxpayer of a processing tax, as part of the sales price of goods sold, was held to constitute income in the year of receipt, even though the validity of the tax was then in dispute, and the tax was refunded by taxpayer to the purchasers in later years (p. 284). Quoting from and following *Burnet* v. *Sanford & Brooks Co., supra,* as expressing a "legal principle * * * often * * * stated and applied," (p. 286), the Court rejected taxpayer's contention, which would have (pp. 285–286)—

> upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system and, for the benefit of the Government or the taxpayer, treated on a basis which is

> neither a cash basis nor an accrual basis, because so to do would, in a given instance work a supposedly more equitable result to the Government or to the taxpayer.

Commissioner v. *Wilcox*, 327 U. S. 404, provides further proof of this Court's acceptance of the "claim of right" doctrine, for there, referring to the *North American Oil* case, *supra*, the Court said (p. 408):

> For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of § 22 (a).

The *Wilcox* case, however, involved the tax liability of an embezzler, and in determining that the amount embezzled was not income for tax purposes, this Court stressed the fact that the embezzler had (p. 408)—

> received the money without any semblance of a bona fide claim of right. And he was at all times under an unqualified duty and obligation to repay the money to his employer.

Wilcox did not overrule or modify the rule of the *North American* case, and reliance upon it by the Court of Claims here (R. 9–10), and in its prior decision, *Gargaro* v. *United States*, 73 F. Supp. 973, 975, is erroneous. In the present case, in contrast to *Wilcox*, the money was received under claim of right, concededly *bona fide*, asserted and continuously maintained by taxpayer under the most solemn circumstances for two years. His obligation to repay was not definite, unconditional or unqualified, but, on the contrary, was disputed and settled only after litigation. His receipt of the money bore no resemblance to a loan, and at the time of receipt and for some time thereafter he had undisputed title and unrestricted use of the money as his own.

Here, as in *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843, the payment (p. 885)—

> violated no law and at most * * * was the breach of a private contract and the recipient was not without all semblance of right and title to them as was the embezzler in *Commissioner* v. *Wilcox* * * *.

The five additional Courts of Appeals, which have had occasion to pass upon the question, have similarly understood the *Wilcox* case.[2] *Fleischer*

[2] In accord, also, are the dissenting opinions of Judge Whitaker, below (R. 12), and in *Gargaro* v. *United States*, 73 F. Supp. 973, 976 (C. Cls.).

v. *Commissioner,* 158 F. 2d 42, 43–44 (C. A. 8th); *Greenfeld* v. *Commissioner,* 165 F. 2d 318, 320 (C. A. 4th); *Currier* v. *United States,* 166 F. 2d 346, 348 (C. A. 1st); *Akers* v. *Scofield,* 167 F. 2d 718 (C. A. 5th), certiorari denied, 335 U. S. 823; *Haberkorn* v. *United States,* 173 F. 2d 587, 590 (C. A. 6th), where it was aptly said:

> The *Wilcox* opinion does not purport to overrule the established principle applied in *North American Oil Consolidated* v. *Burnet.* It was decided upon the particular facts involved, which in the Court's opinion made the usual rule inapplicable.

Nor, contrary to the majority opinion below (R. 10–11), was the scope of the *North American Oil* case limited by *Freuler* v. *Helvering,* 291 U. S. 35. The latter case turned upon the language of a statute (Section 219 of the Revenue Act of 1921) specially providing for division of the tax burden as between an estate and its beneficiaries, by directing taxability to a beneficiary to depend not on the amount of income actually paid to him, but on that payable or "distributable" (pp. 37, 42). Indeed, both cases were decided within two years and by the identical Court, which, in the *Freuler* case, expressly distinguished the *North American Oil* case (there cited by the Commissioner) on the ground that in the *North American Oil* case (p. 43): "Section 219 had no bearing upon the question presented." So, also, with reference to the *North American Oil* case, the

Second Circuit, in *General Outdoor Advertising Co.* v. *Helvering*, 89 F. 2d 882, 883, held—

> we do not consider its scope limited by *Freuler* v. *Helvering*, 291 U. S. 35, 54 S. Ct. 308, 78 L. Ed. 634, which turned upon the language of the section taxing the beneficiaries of a trust.

The *Freuler* case is simply an example of an express statutory exception to the general principle of annual accounting.

C. In the years intervening since its decision in 1932, the *North American Oil* case, *supra*, and the "claim of right" doctrine there enunciated, have repeatedly been followed and applied in a multitude of cases in the lower federal courts of all circuits, without exception, and in the Tax Court.[3] Moreover, the Court of Claims, prior to its decision in 1944 in *Greenwald* v. *United States*, 57 F. Supp. 569, four times followed and correctly applied the "claim of right" principle, as

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[3] See, for example, the following representative decisions by the court of appeals in each of the several circuits: *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473 (C. A. 1st); *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d); *Clay Sewer Pipe Ass'n* v. *Commissioner*, 139 F. 2d 130 (C. A. 3d); *Anderson* v. *Bowers*, 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918; *Akers* v. *Scofield*, 167 F. 2d 718 (C. A. 5th); *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561; *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th), certiorari denied, 311 U. S. 679; *Saunders* v. *Commissioner*, 101 F. 2d 407 (C. A. 10th); *Barker* v. *Magruder*, 95 F. 2d 122 (C. A. D. C.).

established by this Court in the *North American Oil* case: *McDuffie* v. *United States*, 19 F. Supp. 239, 246–247 (1937); *Thomas* v. *United States*, 22 F. Supp. 412, 415 (1938); *Schramm* v. *United States*, 36 F. Supp. 1021 (1941); *Agne* v. *United States*, 42 F. Supp. 66, 72–73 (1941).[4] Only with the *Greenwald* case, *supra*; *Gargaro* v. *United States*, 73 F. Supp. 973, *supra* (on demurrer, 1947), and 86 F. Supp. 840 (on the merits, 1949);[5] and the decision below, did the Court of Claims deviate from the rule established by this Court in the *North American Oil* case, and "the great weight of authority," *Haberkorn* v. *United States*, 173 F. 2d 587, 590 (C. A. 6th), and attempt to substitute a system based on finally-ascertained results of particular transactions.

1. The doctrine has been applied by the lower courts in a variety of situations: (a) In one class of cases, the earning or gain has been held taxable in the year of receipt, even though, as here, the taxpayer's right to the money is subject to dispute, and liability to restore its equivalent may be, or is being, asserted: *Board* v. *Commissioner*, 51 F. 2d 73 (C. A. 6th), certiorari denied, 284 U. S. 658 (director's profit on contract with corporation; right to retain contested by stockholders' cited by this Court in the *North American Oil* case, p. 424; *McDuffie* v. *United States*,

[4] *Wells* v. *United States*, 64 F. Supp. 476, 479–480 (C. Cls.) (1946), represents no departure in principle since the payment there was found, as a matter of fact, to be an advance or loan and not compensation received under claim of right.

[5] In the *Gargaro* case, as here, Judge Whitaker dissented.

19 F. Supp. 239 (C. Cls.), pp. 245–247 (money received by lessee from oil leases, subsequently cancelled for fraud and money judgment obtained by the United States for all sums received); *Thomas* v. *United States,* 22 F. Supp. 412, 415 (C. Cls.) (compensation received for securing contracts, claimed to have been paid under mistake); *National City Bank of New York* v. *Helvering,* 98 F. 2d 93 (C. A. 2d) (director held out part of profits on illegal oil lease, repaid to corporation during Senate investigation); *Griffin* v. *Smith,* 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561 (corporate officer and director paid himself excessive bonuses, refunded on demand of stockholders); *Saunders* v. *Commissioner,* 101 F. 2d 407 (C. A. 10th) (officer's commission on sale of stock, restored on demand); *Commissioner* v. *Alamitos Land Co.,* 112 F. 2d 648 (C. A. 9th) (sum received in payment of judgment of lower state court, later repaid upon reversal by state supreme court); *Penn* v. *Robertson,* 115 F. 2d 167, 173–174 (C. A. 4th) (money received under a stock purchase plan, invalid under state law, rescinded in a subsequent year and gain repaid); *Schramm* v. *United States,* 36 F. Supp. 1021 (C. Cls.) (gain derived from liquidating dividend, subsequently returned to satisfy an additional federal tax assessment on corporation); *Agne* v. *United States,* 42 F. Supp. 66, 72–73 (C. Cls.) (proceeds from sale of stock taxable in year of receipt, although right to their

retention successfully disputed by minority stockholders and later partially repaid); *Moore* v. *Thomas,* 131 F. 2d 611 (C. A. 5th) (money received by underwriting agency, subject to repayment by reason of breach of contract to maintain premium reserve); *St. Regis Paper Co.* v. *Higgins,* 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843 (dividends distributed to stockholders allegedly in violation of declaring corporation's contract, later repaid); *Fleischer* v. *Commissioner,* 158 F. 2d 42 (C. A. 8th) (salaries later repaid to employer corporation, after having been disallowed by federal tax authorities); *Commissioner* v. *Switlik,* 184 F. 2d 299 (C. A. 3d) (gain derived from liquidating dividend, subsequently returned to satisfy an additional federal tax assessment on corporation); *Downing* v. *Commissioner,* 43 B. T. A. 1147 (sum retained by broker out of sales price, partially repaid after dispute and litigation with his principal).

(b) Other cases have held the tax properly collected in the year of receipt, even though the income is subject to an obligation to restore, which is admitted or uncontroverted, but, at the same time, contingent or indefinite: *Chi. R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. A. 7th), certiorari denied, 284 U. S. 618 (overcharges by railroad through mistakes in computation of fares by station agents, the names of the passengers to whom the excess amounts were due being unknown), decided before the *North American Oil*

case; *Blum* v. *Helvering*, 74 F. 2d 482 (C. A. D. C.), certiorari denied, 295 U. S. 732 (profits realized from stock sales, subject to the obligation to support market with a fund in a stated minimum amount by operating a trading pool for six months subsequent); *Fairmount Creamery Corp.* v. *Helvering*, 89 F. 2d 810 (C. A. D. C.) (interest received by corporation from employees to whom stock had been sold on credit, subject to refund in the event employee quit or was discharged); *Barker* v. *Magruder*, 95 F. 2d 122 (C. A. D. C.) (usurious interest, recoverable in the event borrower made claim); *Commissioner* v. *Lyon*, 97 F. 2d 70, 73–74 (C. A. 9th) (cash paid to lessor at beginning of ten-year term, subject to refund on termination of lease otherwise than by default of lessee); *First Nat. Bank* v. *Commissioner*, 107 F. 2d 141 (C. A. 6th) (proceeds of a note held taxable, notwithstanding contingent liability to repay at maturity if maker failed or if purchase of certain corporate assets was not consummated); *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473 (C. A. 1st) (unclaimed deposits and refunds due former customers of gas company); *Detroit Consolidated Theatres* v. *Commissioner*, 133 F. 2d 200 (C. A. 6th) (sum received as advance rental deposit); *Caldwell* v. *Commissioner*, 135 F. 2d 488 (C. A. 5th) ("kickbacks" to state building superintendent paid by contractors, although possibly recoverable by state); *Jacobs* v. *Hoey*, 136 F. 2d 954 (C. A. 2d),

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52
233

certiorari denied, 320 U. S. 790 (irregular advance by estate to executor on account of commissions, before allowance by court); *Clay Sewer Pipe Ass'n* v. *Commissioner,* 139 F. 2d 130 (C. A. 3d) (prepayment for services to be rendered, although under contract recipient may be liable subsequently to return their equivalent); *DeGuire* v. *Higgins,* 159 F. 2d 921 (C. A. 2d) (dividends payable to purchaser of stock subject to possible refund under contract terms); *Akers* v. *Scofield,* 167 F. 2d 718 (C. A. 5th), certiorari denied, 335 U. S. 823 (money received in reliance upon fraudulent representation, subject to recovery in the event of avoidance by defrauded party); *Anderson* v. *Bowers,* 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918 (executor's commissions calculated upon an erroneous basis, subject to refund in the event proper action brought); *Capital Warehouse Co.* v. *Commissioner,* 171 F. 2d 395 (C. A. 8th) (prepayment for services, whose cost taxpayer must defray in later year); *Haberkorn* v. *United States,* 173 F. 2d 587 (C. A. 6th) (bonus subsequently returned to employer because of error in calculation of profits, upon which the bonus was based); *Gilken Corp.* v. *Commissioner,* 176 F. 2d 141, 144–145 (C. A. 6th) (sum received as advance rental deposit).

In each of these cases, as in the instant case, there were present, at the time of receipt, a *bona fide* claim of right to the alleged gain, title to it,

and unrestricted freedom in disposition, and there was absent a definite, unqualified and unconditional obligation to repay or return its equivalent.[6]

2. It makes no difference, of course, that taxpayer was actually required, by the 1946 Illinois

[6] In his brief in opposition to certiorari (p. 7), taxpayer cites *Commissioner* v. *Turney*, 82 F. 2d 661 (C. A. 5th), and *Knight Newspapers* v. *Commissioner*, 143 F. 2d 1007 (C. A. 6th). However, these cases do not represent departures in principle from the holding in the *North American Oil* case, or the other authorities cited above. In the *Turney* case, the court held that the money was received by taxpayer as agent for another, and, hence, the duty to pay the tax was not upon him. Again, *Knight Newspapers* was expressly explained, by the court which decided it, in its subsequent *Haberkorn* case, 173 F. 2d, at p. 590, as not representing a change in "the general rule", but as presenting a factual situation under which the disputed income had never been received by the taxpayer, no claim of right ever asserted, and no economic gain resulted to the taxpayer, who, from the combination of these facts, was regarded as holding it under a constructive trust. On the *Knight* case, see also *St. Regis Paper Co.* v. *Higgins*, *supra*, 157 F. 2d, at p. 885.

Ford v. *Nauts*, 25 F. 2d 1015 (N. D. Ohio), also cited in the brief in opposition (p. 7), was in effect repudiated by the court of appeals in the circuit of its origin in *Ford* v. *Commissioner*, 51 F. 2d 206 (C. A. 6th). Both cases antedated the *North American Oil* case, with which, however, the decision of the court of appeals accords. The holding in an additional District Court case also cited in the brief in opposition (p. 7), *Buder* v. *United States* (E. D. Mo.), decided May 17, 1940, 27 A. F. T. R. 993, judgment amended, April 8, 1941, 29 A. F. T. R. 1379, appeal dismissed, 116 F. 2d 284 (C. A. 8th), is not clear and surely carries little persuasive weight in view of the many later decisions of the court of appeals of the Eighth and other circuits cited above: *e. g.*, see *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th), and *Capital Warehouse Co.* v. *Commissioner*, 171 F. 2d 395 (C. A. 8th).

judgment, to repay the bonus in that year. The courts have repeatedly held receipts in an earlier year taxable then as income, notwithstanding the fact that the taxpayer was actually required to refund them in a subsequent year. *Security Mills Co.* v. *Commissioner*, 321 U. S. 281, 284; *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C. A. 2d); *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561; *Saunders* v. *Commissioner*, 101 F. 2d 407 (C. A. 10th); *Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th); *Penn* v. *Robertson*, 115 F. 2d 167 (C. A. 4th); *Schramm* v. *United States*, 36 F. Supp. 1021 (C. Cls.); *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); *Commissioner* v. *Switlik*, 184 F. 2d 299 (C. A. 3d); *Downing* v. *Commissioner*, 43 B. T. A. 1147 (all discussed *supra*, pp. 25–29). Taxpayer's contingent liability to his employer (in 1944) did not differ from his other debts, which might ripen and be paid in future years.

In this connection, it may also be noted that, while in our view *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th), *supra*, was rightly decided, and the decision of the Court of Claims in *Greenwald* v. *United States*, 57 F. Supp. 569, *supra*, was incorrect, and against the great weight of authority, the instant case is distinguishable from both in that taxpayer here did not recognize, but

on the contrary disputed, the obligation to repay when it was called to his attention. Although the Illinois court eventually held that taxpayer erroneously and mistakenly believed the terms of his employment contract to be different from the agreement as found (R. 7), the instant record presents not a case of mutual mistake, as erroneously ruled by the court below (R. 10), but of breach of contract. Certainly, it is not pertinent to the present problem that in any litigation one party or the other, or both, may be said to have been mistaken on the facts or law. Again, while taxpayer, as an officer of the company, directed payment to himself of the bonus (R. 6), mutual mistake no more arises in such a situation than when, by direction of a lower court, a third party pays a taxpayer a judgment, which later is reversed on appeal and the payment refunded. *North American Oil* v. *Burnet*, 286 U. S. 417, 424, *supra; Commissioner* v. *Alamitos Land Co.*, 112 F. 2d 648 (C. A. 9th), *supra.*

3. Nor has it made any difference that the taxpayer paid the tax, and later sought to obtain a refund. There is not the slightest intimation in any of the decisions applying the "claim of right" doctrine that anything turns on whether the taxpayer voluntarily paid the tax or the Commissioner assessed a deficiency, and, like the present suit, many of the cases have arisen after payment. See *Griffin* v. *Smith*, 101 F. 2d 348 (C. A. 7th), certiorari denied, 308 U. S. 561;

Saunders v. *Commissioner*, 101 F. 2d 407, 408 (C. A. 10th); *Penn* v. *Robertson*, 115 F. 2d 167 (C. A. 4th); *Moore* v. *Thomas*, 131 F. 2d 611 (C. A. 5th); *St. Regis Paper Co.* v. *Higgins*, 157 F. 2d 884 (C. A. 2d), certiorari denied, 330 U. S. 843; *Fleischer* v. *Commissioner*, 158 F. 2d 42 (C. A. 8th); *Jacobs* v. *Hoey*, 136 F. 2d 954 (C. A. 2d), certiorari denied, 320 U. S. 790; *Anderson* v. *Bowers*, 170 F. 2d 676 (C. A. 4th), certiorari denied, 337 U. S. 918; *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th); and the Court of Claims' previous decisions in the *McDuffie*, *Thomas*, *Schramm*, and *Agne* cases, cited *supra*, pp. 25–27.

4. As a consequence of this Court's holding in the *North American Oil* case, and as anticipated in its opinion, where a taxpayer has been obliged to refund the profits received and taxed in the earlier year, he has been allowed a deduction from the profits of the year of refund—not from those of the earlier year. *Boston Consol. Gas Co.* v. *Commissioner*, 128 F. 2d 473, 475 (C. A. 1st); *Commissioner* v. *Switlik*, 184 F. 299 (C. A. 3d); *O'Meara* v. *Commissioner*, 8 T. C. 622, 633–634; see also expressions in *Barker* v. *Magruder*, 95 F. 2d 122, 124 (C. A. D. C.); *Caldwell* v. *Commissioner*, 135 F. 2d 488, 491 (C. A. 5th); *Anderson* v. *Bowers*, 170 F. 2d 676, 679 (C. A. 4th), certiorari denied, 337 U. S. 918. The administrative practice is in accord. G. C. M. 16730, XV–1 Cum. Bull. 179 (1936), issued following the *North American Oil* decision.

The correct rule was only recently aptly summarized by the Court of Appeals for the Fourth Circuit in *Anderson* v. *Bowers*, 170 F. 2d 676, when, referring to the *North American Oil* case and other decisions above cited, it said (p. 679):

> From these decisions it is clear that when income has been received by the taxpayer or credited to him under a claim of right, it must be accounted for in the year in which it was received or could have been received by him; and if it is shown in a subsequent year that the payment was wrongfully made and the taxpayer is required to make restitution, his remedy is not to sue the Collector to recover the excess tax mistakenly paid but to claim the repayment as a deduction from income in a year in which it is made. This procedure is required because income taxes are imposed and must be accounted for on a yearly basis under the decision of *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365, 51 S. Ct. 150, 75 L. Ed. 383.

D. 1. There is no reason or occasion for the Court to change these settled rules. The mass of cases in the lower courts—with the single significant exception of the Court of Claims, in very recent years—is proof in itself that the "claim of right" doctrine has achieved an established status which should be changed, if it is to be changed, only by Congress. And Congress has given not even a hint that the *North American* rule should

be abandoned. It has continued in effect the sweeping language of Section 22 (a) of the Internal Revenue Code, *supra*, p. 2, under which it intends to "include in gross income everything which in fact is 'income derived from any source whatever.'" *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474, 475 (C. A. 2), certiorari denied, 338 U. S. 816. See also *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223; *Helvering* v. *Clifford*, 309 U. S. 331, 334. The provisions for annual accounting also remain in the statute, as they have since the beginning of federal income taxation under the Sixteenth Amendment, and the carefully limited exceptions which Congress has provided in special cases confirm its purpose that the well-understood and consistently applied rules stemming from the annual accounting system shall continue to prevail, unless express statutory direction for the benefit of the Government or the taxpayer is made to the contrary.[7] If it be thought that fair-

[7] Examples of such special legislation are as follows: Internal Revenue Code, Section 43: in cases of fixed liabilities payable in fixed installments over a series of years, deductions are allowed in a year other than that in which actually paid, as explained in *Security Mills Co.* v. *Commissioner*, 321 U. S. 281: Section 44: installment basis income: Section 122: net operating loss deduction: Section 127: war losses: Section 128: recovery of unconstitutional federal taxes: Section 162 (b): cognate of Section 219 of Revenue Act of 1921, construed in *Freuler* v. *Helvering*, 291 U. S. 35, discussed at pp. 23–24, *supra*: Section 3806: mitigation of effect of renegotiation of war contracts or disallowance of reimbursement.

ness requires another exception in the present class of case, the remedy lies in Congress and not in the courts. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 367; *Boehm* v. *Commissioner*, 326 U. S. 287, 295. The legislature alone possesses the information and authority to weigh the general necessity of obtaining revenue promptly, as well as the significance of the additional burden imposed upon the tax administration, against the alleged hardship of these special cases.

2. There are, moreover, good reasons why the *North American* rule should be retained. If, as is the general principle, a taxpayer may not postpone to a subsequent year payment of a tax then due in order to ascertain whether the final outcome of the particular transaction ultimately results in gain or loss, the Government should be able to exact collection, in cases such as this, "without being compelled to take sides in private controversies." *National City Bank of New York* v. *Helvering*, 98 F. 2d 93, 96 (C. A. 2d), *supra*. As Judge Learned Hand there said, it would be "intolerable" to require the tax to be assessed against both parties to the dispute (p. 96)—

> * * * collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant. If he holds with claim of right, he should be taxable as an owner, regardless of any

> infirmity of his title; no other doctrine is practically possible, and no injustice can result.

This reasoning applies, with even greater force to a case, such as this, where there is no actual dispute at the time the return is filed and the tax is paid.

With the income received under claim of right, the taxpayer is in a position to pay the tax, and he is on a par with other taxpayers who have to pay taxes on similar amounts of income in that taxable year. If he is forced to repay the money in a later year, his tax interests are sufficiently protected by the rule that he may then claim a deduction. See *supra*, pp. 33–34; *infra*, p. 41. Meanwhile, he has the unrestricted use of the money, in exactly the same way that earnings are normally available for disposition by a taxpayer.

Though the Court of Claims seems to stress the fact that the taxpayer in this case voluntarily reported the bonus in 1944 and paid the tax thereon (R. 9, 11), we do not read the opinion as laying down the novel rule that the "claim of right" doctrine should be inapplicable where the taxpayer first pays the tax and then seeks a refund. In any event, such a suggestion must be rejected, for the issue in these cases is whether an item of earnings constitutes taxable income for the year of receipt, and that issue must turn on the tax statutes and the judicially

applied concepts of taxable income, and not on the taxpayer's choice in paying, or not paying, the tax. On the question of whether the item is properly includible in taxable income, there should be no difference in result between a proceeding before the Tax Court challenging a deficiency determination and a suit for a refund in the Court of Claims or a district court.

For this reason, the result reached below inevitably encourages failure to return allegedly disputed gains in the year earned, and tends to foster speculation on the part of the irresponsible and unscrupulous at the expense of the Government and the general body of law-abiding taxpayers. The tendency will be to postpone reporting the real or allegedly disputed income until the controversy is settled. Moreover, such speculation will proceed and the tax payment be postponed in connection with profits which, by hypothesis, the taxpayer continues unrestrictedly to use, and claims as rightfully his. This Court, in *Manning* v. *Seeley Tube & Box Co.*, [illegible] S. 561, 568, disapproved a contention leading to like untoward results.

Even eventual collection of the tax is imperiled, if postponed to await settlement of the controversy in the taxpayer's favor, since in the subsequent settlement year taxpayer may no longer possess the means to satisfy the tax on the profit, which in the meantime he has enjoyed and possibly expended.

In general, then, the result reached in the court below runs counter to the principle of prompt collection of the revenue (*Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 566, *et seq.*), and ignores "the basic necessity of the Government to collect a carefully estimated sum of money by a particular date in order to meet its anticipated expenditures." *Rodgers* v. *United States*, 332 U. S. 371, 374.

Another difficulty arising out of rejection of the "annual accounting" system revolves around the statute of limitations. The Illinois court might not have settled the controversy between taxpayer and his employer until after the expiration of the period for filing refund claims. Internal Revenue Code, Section 322 (b) (in general, three years from date of filing return or two years from date of payment of tax). If the annual accounting basis applies, as we urge, the passage of the limitations period would not affect his right to a deduction in the year in which he paid the judgment. However, if the subsequent development determined that the receipt of the bonus in 1944 was never taxable, as seems to be the holding below (R. 11), the expiration of the refund period would appear to leave the taxpayer without any relief. Similarly, if no income is regarded as having been received in the earlier year, a taxpayer might support a claim for tax refund, even though he had never satisfied a judgment which his employer had obtained against him.

These problems necessarily arise if one holds, as does the court below, that the bonus did not "in fact" constitute income to the taxpayer in the year of receipt, and "he did not have the income" in that year, although he actually received it at that time (R. 11). For if an item of earnings is considered not to be income in the year of receipt, no tax need be paid on it, and if a tax is nevertheless paid on such an item, it may be recovered by refund claim during the limitations period, but thereafter there is no remedy. Nor would it be proper to attempt to avoid these difficulties by giving the taxpayer the option either to claim the original payment as non-income in the year of receipt or to treat the repayment as a deduction in a later year. Aside from the theoretical obstacles, such a choice would enable the taxpayer to select the most advantageous tax treatment and, by the same token, would discriminate against the Government, which would not have a similar option. And even if the loss-deduction treatment is limited to cases in which the statute of limitations has run, there is the double objection that a substantial unwarranted exception is made in the coverage of that statute, to the Government's detriment, and that taxpayers will be treated differently depending upon the length of time it takes to settle the underlying private controversy. In any case, adoption of these rules would require legislative intervention, and may not appropriately be made by the courts.

On the other hand, allowance of a deduction in the year taxpayer repays sums previously returned as income (see pp. 33–34, *supra*), conforms with the principle of annual accounting and creates no great injustice for the taxpayer or the Government. True, in a particular instance, as where the later year is a loss year, some hardship may result.[8] However, in other cases, the rule will redound to taxpayer's benefit, as, for example, where the tax rates in the later year are higher than those of the earlier year, or where no tax was due in the earlier year, by reason of a net loss. *O'Meara* v. *Commissioner*, 8 T. C. 622, 632–634. The system of annual periods of computation, which Congress has elected and to which it has consistently adhered since the inception of the income tax—as contrasted with a basis of finally ascertained results of particular transactions—affords equity in general and works no particular injustice in the present class of case. See also discussion, pp. 15–17, 34–37, *supra*. The many difficulties implicit in the decision below (*supra*, pp. 36–40) demonstrate the general fairness and practicality of the present rule, as well as the intrinsic legislative character of any change which could be adopted.

[8] Such hardship is alleviated by the net operating loss carry-back provisions (Internal Revenue Code, Section 122), creating an express exception to the annual accounting system and authorizing the total net operating loss for one year to be added to deductions of a preceding year. See *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 566.

CONCLUSION

The decision of the Court of Claims should be reversed.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, A.D. 1950.

UNITED STATES OF AMERICA,
Petitioner,

vs.

ELLIS R. LEWIS,
Respondent.

On Petition For a Writ of Certiorari to the United States Court of Claims

---

BRIEF FOR RESPONDENT IN OPPOSITION.

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Of Counsel.

INDEX.

	PAGE
Opinion below	1
Jurisdiction	2
Question Presented	2
Statute Involved	2
Statement	3
Argument	5
I. The Decision Below Is Clearly Correct	5
II. There Is No Actual Conflict In the Decisions	11
III. This Case Presents No Important Question of Federal Law	13
Conclusion	16

CITATIONS.

Cases:

Buder v. United States, (not officially reported) 41-2 USTC ¶ 9513, 40-1 USTC ¶ 9477, app. dism., 116 Fed. (2d) 284 7

Commissioner v. Turney, 82 Fed. (2d) 661 7

Commission v. Wilcox, 327 U.S. 404 ..... 8, 9, 10, 11, 12, 13, 16

Ford v. Naats, 25 Fed. (2d) 1015 7

Freuler v. Helvering, 291 U.S. 35 ..... 6, 7, 11, 12, 13

PAGE

Gargaro v. United States, 109 C. Cls. 528, 114 C. Cls. 704 ..... 11, 13

Greenwald v. United States, 102 C. Cls. 272 ..... 11, 13

Haberkorn v. United States, 173 Fed. (2d) 587 12

Knight Newspapers, Inc. v. Commissioner, 143 Fed. (2d) 1007 7

Leather Manufacturers' Bank v. Merchants' Bank, 128 U.S. 26 9

Lewis v. United States, (R. 4-13) 11

North American Oil v. Burnet, 286 U.S. 417 ..... 7, 8

Poindexter v. The Equitable Life Assurance Society, 127 W. Va. 671 9

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American Law Institute, Restatement of Law of Restitution, §§ 18, 20 9

5 Williston on Contracts (Rev. Ed.) § 1574 9

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BRIEF FOR RESPONDENT IN OPPOSITION.

Opinion Below.

The special findings of fact, conclusions of law, and opinion of the Court of Claims (R. 4-11) together with the dissenting opinion of Judge Whitaker (R. 11-13) are not yet reported.

Jurisdiction.

The jurisdictional requisites are adequately set forth in the Petition.

Question Presented.

The question presented is not adequately stated in the Petition.

The question presented is: Where, as the result of a mistake, the respondent, who was in complete charge of the operations of his corporation-employer, directed the payment to himself and received, as part of his compensation for 1944, a bonus in excess of that to which he was entitled, and the excess bonus mistakenly paid was repaid by the respondent to his employer in 1946, pursuant to a court decree which found that the excess bonus had been paid by mistake and ordered its repayment, and the employer in 1945 filed an amended income tax return for 1944, in which it deducted only the amount of bonus to which respondent was entitled, and paid the additional 1944 tax, plus interest, due by reason of not deducting in the amended return the excess bonus, is the excess bonus mistakenly paid to the respondent excludable from his income for 1944, and should the tax paid by the respondent on account of said excess bonus be refunded to him?

Statute Involved.

The pertinent provisions of the Internal Revenue Code are set forth in the Petition (p. 2).

STATEMENT.

This is a suit for refund of income taxes paid for the calendar year 1944, and interest and penalty assessed and paid by reason of a late payment of part of said taxes.

The statement made in the Petition is substantially correct. There are a few inaccuracies and omissions in said statement which will be corrected here.

It is not correct to say that the president of respondent's employer (the "Company") "did not participate substantially in the management of the business" during 1944 (Petition, p. 3). The fact is that the president of the Company was in Florida during the year 1944, and during no time in that year participated in the conduct of the business of the Company other than to have one or two telephone conversations with the respondent and two meetings with the respondent, once in New York City and once in North Carolina (R. 5-6).

The essential facts with respect to the overpayment of respondent's bonus due to a mistake are as follows:

During the year 1944, the respondent's compensation agreement with his employer was that the respondent was to receive a salary and in addition thereto a bonus of 10% of the net profits of the company. In fact, the agreement was that, for the purpose of computing respondent's said bonus, "net profits" were the net profits of the Company *after* deducting therefrom federal income taxes thereon (R. 7, 9). The bonus to which respondent was entitled, computed in accordance with said agreement, amounted to $11,067.94.

The respondent erroneously and mistakenly believed and understood said agreement to be that, for the purpose of

computing the respondent's said bonus, "net profits" were the net profits of the Company *before* deducting therefrom federal income taxes thereon (R. 6, 7, 9). Pursuant to such mistake of fact as to said agreement, the respondent, as the active head of the Company, directed the payment, and received from the Company, as part of his compensation for the year 1944 a bonus in the sum of $21,924 computed on net profits before deducting therefrom federal income taxes thereon, which said bonus was $10,856.06 in excess of the amount to which he was entitled from the Company for said year under said agreement as it actually was (R. 6, 7).

The Company, when it filed its original income tax return for 1944, which tax it paid, deducted, as part of the compensation paid to the respondent, the sum of $21,924, the bonus paid to the respondent as the result of said mistake of fact (R. 6, 7). In 1945, the Company filed an amended return, in which it deducted, as compensation to the respondent, only the sum of $11,067.94, the bonus correctly computed and to which the respondent was actually entitled, and it paid the additional tax due from the Company under said amended return (R. 6).

In a suit in the Circuit Court of Cook County, Illinois, between respondent and the Company, the Court found, in December, 1946, as of November, 1946, that the agreement between respondent and the Company was that the respondent's bonus should be computed upon profits *after* taxes, that respondent erroneously believed and understood that the bonus was to be computed *before* deduction of taxes, and that by virtue of this mistake respondent received the sum of $10,856.06 in excess of the amount to which he was entitled under the agreement; and said Court, in its decree, entered a judgment against the respondent for said amount and the respondent, pursuant to said decree, refunded said money to the Company in 1946 (R. 7, 9).

ARGUMENT.

The situation presented by this case is that of a claim by a taxpayer for a refund of that part of his 1944 income taxes, which he paid because he included in the income for that year an excess bonus to which he was not entitled and which he received as a result of a mistake, and which he refunded in 1946. The sole question is: Was that excess bonus taxable income for 1944? If it was not, the decision of the United States Court of Claims is correct and the Petition for Certiorari should be denied.

I.

The Decision Below Is Clearly Correct.

The petitioner's sole claim is that the respondent received the excess bonus in 1944 under a claim of right; that therefore the so-called "claim of right" doctrine applies to this case and under it the respondent is not entitled to a refund of the income taxes he paid for 1944 on the excess bonus.

In asserting this position, petitioner ignores the fundamental fact that the respondent, when in 1944 he received the excess bonus, was not entitled to it and that he received it because of a mistake. This fundamental fact makes the so-called "claim of right" doctrine inapplicable to this case, and entitles the respondent to a refund of the income taxes paid by him on said excess bonus. This Court has so held. Other courts have so held. Reason and every principle of equity support that conclusion.

It is true that when the respondent received the excess bonus he believed that he was entitled to it. But the

existence of that belief does not bring this case within the "claim of right" doctrine, although the petitioner apparently bases its case entirely upon the fact of said belief. The important fact, distinguishing this case from those cases where the "claim of right" doctrine applies, is that, at the time respondent received the excess bonus, he was *not* entitled to it and it was paid to him and he received it because and as the result of a mistake. Therefore, although the respondent got physical possession of the excess bonus in 1944, it never belonged to him, he never had any right to it and it was not part of his 1944 taxable income. The principles governing this situation were clearly set forth by this Court in the case of

Freuler v. *Helvering*, 291 U.S. 35.

In that case this Court held that, where beneficiaries of a trust had been paid the entire income therefrom, and thereafter a court having jurisdiction over the trust had determined that the trustee should not have distributed the entire income, but, even though the trust instrument made no mention thereof, he should have withheld a portion thereof on account of depreciation, and ordered the repayment by the beneficiaries of the amounts received by them which should have been withheld on account of depreciation, such excess was properly not reported as income by the beneficiaries. This Court was of the opinion that, since it had been determined that the excess should never have been paid to the beneficiaries, that they were not entitled thereto and that they were obligated to repay the same, it did not come within the concept of taxable income.

This Court said (p. 42):

> "* * * The test of taxability to the beneficiary is not receipt of income, but the present right to receive it. Clearly an overpayment to a beneficiary by mistake of law or fact, would render him liable for the taxable year under consideration, not on the amount paid, but on that payable."

The dissent of Justices Cardozo, Brandeis and Stone in that case was not based on any dissent from the principle announced above, but on the position that the beneficiaries had not in fact repaid to the trustee that part of the income to which the beneficiaries were not entitled. The principle determining the case and which is determinative of the instant case was approved in the dissenting opinion.

In the instant case, the respondent paid the tax on the excess bonus in 1945, when he paid his 1944 income tax, and in 1946 repaid in full to the Company the amount of the excess bonus.

The *Freuler* decision, which was decided by this Court subsequent to the case of *North American Oil* v. *Burnet*, 286 U.S. 417, which case is the main reliance of petitioner, has been completely ignored by the petitioner in its Petition for Certiorari, although the *Freuler* decision was discussed at length and relied upon in the opinion of the Court below.

There are numerous other authorities which sustain the principle laid down by this Court in the *Freuler* case. Some of these are:

Knight Newspapers, Inc. v. *Commissioner*, 143 Fed. (2d) 1007 (C.C.A.-6, 1944).

Commissioner v. *Turney*, 82 Fed. (2d) 661 (C.C.A.-5, 1936).

Buder v. *United States*, (not officially reported), Case No. 11718, U.S.D.C., E.D. Mo. (1941), 41-2 USTC ¶9513, 40-1 USTC ¶9477, *app. dism.* 116 Fed. (2d) 284.

Ford v. *Nauts*, 25 Fed. (2d) 1015 (U.S.D.C., N.D. Ohio, 1928).

As we have said, petitioner primarily bases its position

on certain language in the opinion of *North American Oil* v. *Burnet*, 286 U. S. 417. The Court below said that this language was *obiter*.

In the later case of

Commissioner v. *Wilcox*, 327 U. S. 404,

this Court in language, which was not *obiter*, stated the correct rule explicitly. In that case Wilcox had embezzled certain funds from his employer, later gambling and losing them. He failed to report the embezzled moneys as income, and the Commissioner sought to assess a deficiency. This Court held that the embezzled funds did not constitute income within Sec. 22(a) of the Internal Revenue Code, which is the statute here involved. This Court rejected the Commissioner's contention that the "claim of right" doctrine was applicable and concluded that the correct rule was (p. 408):

> "that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain."

Under the facts in the instant case, the "claim of right" doctrine is not applicable because neither of the tests laid down in the *Wilcox* case has been met.

First, there was no presence of a "claim of right" to the excess bonus. Petitioner attempts to make it appear that when the excess bonus was paid and received the correct amount was in dispute. Such was not the fact. The excess bonus was paid under the mistaken belief by both the respondent and the Company that the respondent was entitled to it. The belief of the respondent and the Company that respondent was entitled to the money, being based upon a mutual mistake, is not a "claim of right" by respondent at all. The mistake has the effect of nullifying the supposed claim of right.

Second, there was a definite unconditional obligation on the part of the respondent to repay or return the excess bonus, which obligation arose at the moment he received the bonus.

One who receives money under a mistake is subject to such obligation.

Leather Manufacturers' Bank v. *Merchants' Bank*, 128 U.S. 26.

Poindexter v. *The Equitable Life Assurance Society*, 127 W.Va. 671.

5 *Williston on Contracts* (Rev. Ed.), § 1574 and cases there cited.

American Law Institute, *Restatement of Law of Restitution*, §§ 18, 20.

In the *Leather Manufacturers' Bank* case, this Court held that, if a bank, upon which a check is drawn payable to a particular person or order, pays the amount of the check to one presenting it with a forged endorsement of the payee's name, both parties supposing the endorsement to be genuine, a right of action to recover back the money accrues at the date of the payment, and the statute of limitations begins to run from that date.

In the *Poindexter* case, excess premiums were paid to an insurance company as a result of the mutual mistake of the insured and the insurer. The Court said (pp. 681-682):

> "The payment and receipt of these excess sums was a purely mutual mistake, raising no blame against either party. * * * The insured had the absolute right to recover these excess payments from the instant they were paid, and the insurer the duty, equally absolute, to repay them. Thus stood their rights immediately after the payments."

In order to avoid the consequence of *Commissioner* v.

Wilcox, 327 U.S. 404, the petitioner has contended (Petition, p. 8) that the respondent's obligation to repay the excess bonus arose for the first time when the Circuit Court of Cook County entered its decree. This contention is erroneous. All the facts which fixed the rights and obligations of the parties occurred in 1944. The decree of the Circuit Court was simply declaratory of the direct, unconditional obligation which came into existence in 1944, at the moment the excess bonus was received by the respondent, and not in 1946, when the Circuit Court decree was entered.

Analogous situations are innumerable. For instance, if a statute is declared unconstitutional and void by a court of last resort, there is no doubt that the statute was void from the date of its enactment. Likewise, there is no doubt that, if a contract is declared void because it is against public policy, it was void from its inception.

The refund provisions of the Internal Revenue Code present similar instances: In 1944, A receives money which he erroneously and mistakenly believes is income and reports it as such. In 1946, the Commission of Internal Revenue determines that the transaction was a gift and not income to A. Would the Commissioner have any hesitancy in refunding the excess income tax paid by A for 1944? Or to state the converse situation: In 1944, A receives money which he honestly believes is a gift and, therefore, does not report it as income for 1944. The Commissioner in 1946 concludes that the money received by A in 1944 was not a gift, but was income. A, accepting the decision of the Commissioner, desires to report the money received as income in 1946, when it was determined that it was income and not a gift to him. Would the Commissioner permit A to do this? He would not. He would insist that A report the money received as part of his 1944 income and pay an additional tax for 1944.

The Court of Claims has consistently taken the position that one who receives money as the result of a mistake of fact is, at the time he receives it, under the definite, unconditional obligation to repay or return it; that the "claim of right" doctrine does not apply to such a situation; and that money so received and later repaid or returned, is not taxable income.

Lewis v. *United States*, (R. 4-13);
Greenwald v. *United States*, 102 C. Cls. 272;
Gargaro v. *United States*, 109 C.Cls. 528 (1947), 114 C.Cls. 704 (1949).

This, we submit, is the correct rule of law and follows the rule explicitly laid down by this Court.

II.

There Is No Actual Conflict In The Decisions.

There is only an apparent and not an actual conflict of authority in the decisions of the federal courts. This Court held unequivocally in the case of *Freuler* v. *Helvering*, 291 U.S. 35, that an overpayment to a person because of a mistake of law or fact would not make him liable for income tax in the year he received the overpayment and that income taxes would not be due on the amount paid, but on the amount actually payable, *i. e.*, the correct amount, excluding the overpayment made by mistake.

In the case of *Commissioner* v. *Wilcox*, 327 U.S. 404, this Court stated the principles of law which govern this case and which were applied by the Court below. Therefore, no new principle of law or no actual conflict as to the law is presented to this Court for decision by the Petition in this case. There may be decisions in the lower federal courts due to difference in applying principles of law to different facts. That divergence does not call for this

Court to review this case for the purpose of restating principles of law which it has already clearly stated. Nor does the fact that some courts have misinterpreted or failed to apply the principles of law announced by this Court create a conflict in the decisions of the federal courts which warrants the granting of a Petition for Certiorari.

The Court in the case of *Haberkorn* v. *United States*, 173 Fed. 2d 587 (C.A. 6, 1949) did say that a different rule than the one it used had been applied by the Court of Claims, and the Court of Claims in the opinion below said that it was aware that in the *Haberkorn* decision, upon similar facts the Court reached a contrary conclusion. However, we respectfully suggest that there is no real conflict to be resolved by this Court, because the Court of Claims has followed the principles of law laid down by this Court, while the *Haberkorn* case has ignored the principles laid down in *Freuler* v. *Helvering*, 291 U.S. 35, and has concluded that the principles of the *Wilcox* case were not applicable to the facts in the *Haberkorn* case. Neither in the District Court (78 F. Supp. 192, U.S.D.C., E.D. Mich., 1948) nor in the Court of Appeals, in the *Haberkorn* case, was the decision of this Court in *Freuler* v. *Helvering*, 291 U.S. 35, discussed or even mentioned. The Court of Appeals did discuss the case of *Commissioner* v. *Wilcox*, 327 U. S. 404, and that discussion shows that the *Haberkorn* case does not present a conflict of law with the decision of the Court below in this case. The Court in the *Haberkorn* case said the rule announced in the *Wilcox* case was not applicable to the facts in the *Haberkorn* case because the obligation of Haberkorn to repay the money he received in 1942 did not arise when he received it, but in 1944 when, apparently, he agreed to repay it. In the words of the Court (p. 590):

> "Subsequent developments in a later year gave rise to the obligation to repay it."

It thus appears that, so far as the rule in the *Wilcox* case is concerned, the *Haberkorn* case does not sustain petitioner's position here and presents only a different set of facts from that in the instant case and not a principle of law conflicting with the principle which, respondent submits, applies in the instant case.

III.

This Case Presents No Important Question Of Federal Law.

Respondent suggests that, although the result of this case is of financial importance to him, the case is of little importance otherwise. No vital or fundamental question of law is involved. This is apparent from petitioner's own conduct. Petitioner says that the principle of law applied by the Court below, and which it says is erroneous, is identical with that announced by the Court of Claims in two previous cases, *Greenwald* v. *United States*, 102 C.Cls. 272 (1944) and *Gargaro* v. *United States*, 109 C.Cls. 528, (on demurrer, 1947), 114 C.Cls. 704 (decision on merits, 1949). In both of these cases the United States was the losing party and in neither did the United States file a Petition for Certiorari in this court. It is evident that the Solicitor General of the United States did not believe that the question of law involved was of sufficient importance to warrant the filing of a Petition.

The instances in which the law here involved would be applied to facts similar to these here presented have been and would be infrequent and also of no great significance from an economic point of view.

Petitioner claims that an issue of importance in the administration of the income tax law is presented in the instant case, because tax accounting must be on an annual basis, and if the law, as announced by the Court of Claims in this case, would be permitted to stand, the entire revenue of the United States would have havoc wreaked upon it.

This contention, to speak mildly, is the product of a vivid imagination. Of course, the revenues of the United States must be determined on an annual basis and that is exactly what respondent is contending for and nothing in the opinion below contravenes this principle. That tax accounting of the United States must be on an annual basis means no more than that a taxpayer's annual tax shall be based upon events which occur entirely within the tax year. That proposition is not violated by the decision below. All of the events which deprived the excess bonus received by the respondent of its character as taxable income, occurred in 1944. The decision of the Circuit Court of Cook County, Illinois, in 1946 merely recognized and confirmed what actually occurred in 1944. This has been discussed and need not be repeated. It is clear that the excess bonus which the respondent received in 1944 was not income when it was received in 1944; if it was not income in 1944, the income tax which respondent paid on it for 1944 should not have been paid and should be refunded to him.

Petitioner's alarm that, if the decision below is permitted to stand, taxes would remain unpaid until a determination of whether income received can be retained, is unwarranted by the facts of this case. In this case respondent paid his taxes when the excess bonus was received and did not ask the Government to wait. Now that the error in payment of such taxes has been discovered, respondent is simply asking to have refunded to him the taxes which he was not obligated to pay in the first instance.

The income tax law itself is replete with instances which would wreck more havoc on the revenue of the United States than would the application of the law laid down by the Court of Claims in this case. For instance, if A in March, 1945 files his income tax return for 1944 and makes

a clerical error in that return, or includes in his income for 1944 that which is not income, or excludes from his income for 1944 that which is income, it is his duty and it is the duty of the Commissioner of Internal Revenue to correct the mistake. The result is that A, when the mistake is discovered, pays an additional tax for 1944 or is refunded part of the tax he paid for 1944. He does not pay an additional tax or make a deduction from his income for the year in which the mistake is discovered.

In 1945, when the Company discovered the mistake it had made, it filed an amended 1944 income tax return and paid an additional tax (R. 9). Respondent paid income tax upon the entire compensation received by him in 1944, including the excess bonus for that year. Had the Company waited until the excess bonus had been repaid to it in December 1946 and had it attempted to include the money repaid in its 1946 return, and at the same time to have stood by its original 1944 income tax return, would the petitioner have approved? It certainly would not have! Under what theory of consistency, fairness and justice can the petitioner take the position that it was entitled to the additional income tax paid by the Company for 1944, but that the respondent here is not entitled to a refund of the taxes he paid for 1944 upon the money received by him as the result of a mistake, and which, when he received it, he was under the unconditional obligation to return, and which he did return?

The Court below found that the agreement between the respondent and the Company was that the respondent's compensation in 1944 was 10% of the net profits of the Company *after* taxes (R. 7, 9). Therefore, when the respondent received the excess bonus only one of two possibilities existed: Either (1) respondent embezzled the excess

bonus, because he caused the Company to pay it, and he received it, knowing that the agreement between him and the Company was that his bonus was to be computed *after* taxes; or (2) he caused the Company to pay it, and he received it, as the result of a mistake by the Company and by himself individually, the mistake being that *at that time* both the Company and the respondent believed the agreement was that the respondent's bonus was to be computed *before* taxes, whereas in fact the agreement was that the bonus was to be computed *after* taxes. Upon the authority of *Commissioner* v. *Wilcox*, 327 U.S. 404, if respondent embezzled the excess bonus, he is entitled to a refund. It would indeed be an anomaly if respondent were to be entitled to a refund if he embezzled the excess bonus, but not entitled to it if he received it as a result of an honest mistake. That would hardly be fair or just or sensible.

From every point of view of the equities of the situation, as well as the law, the respondent is entitled to the refund to which the Court of Claims said he was entitled.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

SIGMUND W. DAVID,

Attorney for Respondent.

ARTHUR C. CHAPMAN,
Of Counsel.

November, 1950.

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No. 347

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1950.

UNITED STATES OF AMERICA,

Petitioner,

vs.

E[redacted]R. LEWI[redacted]

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENT.

SIGMUND W. DAVID,
Attorney for Respondent.

ARTHUR C. CHAPMAN,
Of Counsel.

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INDEX.

	PAGE
Question Presented	1-2
Statutes Involved	2
Statement	2
Summary of Argument	3-8
I. Petitioner has misconceived the issue in this case. Consequently, most of its argument and the authorities cited in support thereof are not germane to the issue.	3-4
II. The excess bonus received by taxpayer in 1944 as the result of a mistake was not taxable income of the taxpayer.	4-5
III. The so-called "claim of right" doctrine is not applicable to the facts in this case.	5-6
IV. The position of the Government is unjust and unfair to the taxpayer.	7-8
Argument	9-33
I.	9-15
II.	16-24
III.	24-30
IV.	30-33
Conclusion	34

AUTHORITIES.

Cases:

Barker v. McGruder, 95 F. 2d 122 28
Chi. R.I.&P.R. Co. v. Commissioner, 47 F. 2d 990 28
Commissioner v. Wilcox, 327 U.S. 404 ..... 6, 7, 24, 28, 29, 30, 31
Freuler v. Helvering, 291 U.S. 35 ..... 5, 13, 14, 20, 21, 22, 23, 24, 27
Gargaro v. United States, 73 F. Supp. 973 ..... 25, 26, 30, 31, 33
Greenwald v. United States, 57 F. Supp. 569 ..... 25, 32
International Bank v. Bartalott, 11 Ill. App. 620 17
Leather Manufacturers' Bank v. Merchants Bank, 128 U.S. 26 17
Lewis v. United States, 91 F. Supp. 1017 ..... 13, 22, 30, 33
National City Bank v. Helvering, 98 F. 2d 93 28
New York Life Insurance Company v. State, 192 Wis. 404 17
North American Oil Consolidated v. Burnet, 286 U.S. 417 ..... 6, 9, 10, 24, 26, 27, 28, 29, 30
Poindexter v. The Equitable Life Assurance Society, 127 W. Va. 671 ..... 17, 18
Richardson v. Bales, 66 Ark. 452 17
Saltonstall v. Hassett, et al. (U.S.D.C. Mass. 1940) 32 F. Supp. 583 23
Sturgis v. Preston, 134 Mass. 372 17

Statutes:

Revenue Act of 1921, c 136, 42 STAT. 227, Sec. 219(d) 22

Texts:

American Law Institute, Restatement of Law of Restitution, §§ 18, 20 17
5 Williston on Contracts (Rev. Ed.) § 1574 17

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1950.

UNITED STATES OF AMERICA,

Petitioner,

VS.

ELLIS R. LEWIS,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR RESPONDENT.

QUESTION PRESENTED.

The question presented is not adequately or properly stated by petitioner.

The question presented is: Where, as the result of a mistake, the respondent, who was in complete charge of the operations of his corporation-employer, directed the payment to himself and received, as part of his compensation for 1944, a bonus in excess of that to which he was entitled, and the excess bonus mistakenly paid was repaid

by the respondent to his employer in 1946, pursuant to a court decree which found that the excess bonus had been paid by mistake and ordered its repayment, and the employer in 1945 filed an amended income tax return for 1944, in which it deducted only the amount of bonus to which respondent was entitled, and paid the additional 1944 tax, plus interest, due by reason of not deducting in the amended return the excess bonus, is the excess bonus mistakenly paid to the respondent excludable from his income for 1944, and should the tax paid by the respondent on account of said excess bonus be refunded to him?

STATUTES INVOLVED.

It is respondent's position that Section 22 (a) of the Internal Revenue Code is the only section relevant to the issue in this case, and that Sections 41 and 42 are not relevant.

STATEMENT.

The statement made by petitioner is correct. For convenience, hereinafter the respondent will be called the "taxpayer" and his employer the "Company."

SUMMARY OF ARGUMENT.

I.

Petitioner Has Misconceived The Issue In This Case. Consequently, Most Of Its Argument And The Authorities Cited In Support Thereof Are Not Germane To The Issue.

Petitioner's argument is a treatise on the rules of accounting applicable to income taxes, plus an indulgence in speculation concerning feared and highly theoretical dire results of an affirmance of the judgment entered by the Court of Claims. Petitioner argues as if the issue presented in this case was a problem in accounting. Consequently, and perhaps intentionally, the argument adroitly and sedulously avoids and circumvents the actual issue in this case. Petitioner says (Petitioner's Brief, p. 12): "The issue here is, essentially, in which year should the balancing deduction be taken—the year of receipt or the year of refund?" Petitioner has misconceived the issue. The issue is: "Was the excess bonus paid to taxpayer in 1944 as a result of a mutual mistake of taxpayer and the Company and repaid by taxpayer to the Company in 1946, taxable income of the taxpayer?"

Having misconceived the issue, petitioner has naturally argued around it and not on it, and it follows that most of its argument and the cases cited in support thereof are not germane to the issue. Consequently, a detailed reply to petitioner's argument or a discussion of the cases cited in support thereof will not serve either to clarify or to determine the issue.

Petitioner's speculation follows a wide trail—a trail that leads nowhere, so far as the determination of the issue here presented is concerned. Petitioner speculates that the affirmance of the decision of the Court of Claims may tend to foster delayed payments of income taxes by irresponsible and unscrupulous persons; that it may imperil eventual collection of income taxes from taxpayers because they may have the financial ability to pay taxes in one year and not in another; and that it may result in injustice because a taxpayer may not be able to obtain the refund to which he is entitled because of the running of the Statute of Limitations. None of these speculative possibilities help to determine the question whether the money received by the taxpayer in 1944, to which the taxpayer was not entitled and which he had a definite and unconditional obligation to return from the moment of its receipt, and which he did return, was taxable income.

II.

The Excess Bonus Received By Taxpayer In 1944 As The Result Of A Mistake Was Not Taxable Income Of The Taxpayer.

Both the Circuit Court of Cook County, Illinois, and the United States Court of Claims found that the excess bonus received by the taxpayer was paid to him and received by him as the result of a mistake (R. 7, 9). When taxpayer received the excess bonus he was not entitled to it; although he got physical possession of it in 1944, it never belonged to him, he did not have title to it, and from the moment that he received it he was under the definite, unconditional obligation to return it. One who receives money as the result of a mistake is subject to such obligation. All of the facts which fixed the rights and obliga-

tions of the taxpayer and the Company occurred in 1944. The direct and unconditional obligation of the taxpayer to return the excess bonus came into existence immediately from the moment the bonus was received. It did not come into existence in 1946, when the decree of the Circuit Court of Cook County, Illinois ordered the taxpayer to return the bonus. The decree of the Circuit Court did not create the obligation but was simply declaratory of it. Therefore, under the principles settled by this Court, the excess bonus was not taxable income to the taxpayer.

The essence of petitioner's argument is that whatever money is received by a taxpayer is taxable income. This is not what Section 22(a) of the Internal Revenue Code says. Taxable income must be gains or profits or income. The money paid to the taxpayer because of a mistake was actually neither gain nor profit nor income. This principle has been declared by this Court in *Freuler* v. *Helvering*, 291 U.S. 35. The fact that the question there arose under a different section of the Internal Revenue Code from the one here involved does not affect the principle declared.

III.

The So-called "Claim Of Right" Doctrine Is Not Applicable To The Facts In This Case.

Petitioner's main position is that the so-called "claim of right" doctrine governs this case, and that the Court of Claims erroneously failed to apply that doctrine. In order to arrive at this position petitioner has consistently attempted to gloss over, ignore and escape from the one vital fact in this case: namely, that the excess bonus was paid to and received by the taxpayer as the result of a

mistake. Where such is the case, the so-called "claim of right" doctrine does not apply, for two reasons: (1) As has been said by the Court of Claims, the "claim of right" is neutralized by the mistake, and (2) the so-called "claim of right" doctrine relied upon by petitioner and stated in *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, has been limited or more clearly defined by this Court in *Commissioner* v. *Wilcox*, 327 U.S. 404, decided many years after the *North American Oil* case. In the *Wilcox* case this Court carefully considered the "claim of right" doctrine and concluded that the correct rule was (p. 408): "that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain, and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute gain." The facts in the instant case meet neither of the tests laid down in the *Wilcox* decision. There was no presence of a claim of right to the excess bonus, and there was a definite, unconditional obligation on the part of the taxpayer to repay or return the excess bonus, which obligation arose at the moment he received the bonus. Therefore, the "claim of right" doctrine does not apply to the facts in this case.

Taxpayer is not arguing whether the "claim of right" doctrine is good or bad, or whether it should be changed or modified; his position simply is that said doctrine is not applicable. That was the decision of the Court of Claims. That has been its position in previous cases. The Court of Claims has not, as petitioner asserts, "deviated" from the "claim of right" rule. It has applied the rule when the rule was applicable; it has refused to apply it when the rule was inapplicable because the receipt of money was due to a mistake.

IV.

The Position Of The Government Is Unjust And Unfair To The Taxpayer.

The Circuit Court of Cook County, Illinois and the Court of Claims, found that the agreement between the taxpayer and the Company was that the taxpayer's bonus for 1944 was to be ten per cent of the net profits of the Company *after* taxes (R. 7, 9). Therefore, when the taxpayer was paid and received the excess bonus (the difference between ten per cent of the net profits of the Company before taxes and ten per cent of the net profits after taxes) only one of two possibilities existed: Either (1) the taxpayer embezzled the excess bonus because he caused the Company to pay it, and he received it, knowing that the agreement between him and the Company was that his bonus was to be computed after taxes; or (2) he caused the Company to pay it, and he received it, as the result of a mutual mistake by the Company and by him. Upon the authority of *Commissioner* v. *Wilcox*, 327 U.S. 404, if the taxpayer embezzled the excess bonus, he is entitled to a refund. It would indeed be an anomaly if the taxpayer were entitled to the refund claimed by him if he embezzled the excess bonus, but not entitled to it if he received it as the result of an honest mistake.

In 1944 the taxpayer received the excess bonus as the result of an honest mistake, and he paid income taxes upon it. The Company, in its 1944 return, deducted the excess bonus paid to the taxpayer as an expense of the business and paid income taxes accordingly (R. 6). In 1945 the Company filed an amended 1944 return in which it deducted, as bonus compensation to taxpayer, the sum of $11,067.94 instead of the $21,924.00 deducted in its original return, and paid the additional tax based on the recompu-

tation (R. 6). Therefore, the Government has received as income taxes for 1944, from the Company, its taxes based upon a deduction of the amount which was actually due to the taxpayer and which was $10,856.06 less than the amount that he was mistakenly paid in 1944, and, from the taxpayer, taxes based upon the amount mistakenly paid to him, and which was $10,856.06 in excess of the amount to which he was entitled. Thus, both the Company and the taxpayer paid income taxes for 1944 upon the excess bonus, which the taxpayer later refunded. Under no theory of consistency, fairness or justice can petitioner maintain the position that it is entitled to the additional income tax p... l by the Company for 1944, but that the taxpayer is not entitled to a refund of the additional income tax for 1944 paid by him. As has been said by the Court of Claims in this case and similar cases, the Government's retention of the tax in this case is essentially unjust, and there is nothing to be said for it morally.

ARGUMENT.

I.

Petitioner Has Misconceived The Issue In This Case. Consequently, Most Of Its Argument And The Authorities Cited in Support Thereof Are Not Germane To The Issue.

Petitioner's argument is a learned treatise on the rules of accounting applicable to income taxes, plus an indulgence in speculation concerning the feared and highly theoretical dire results of an affirmance of the judgment entered by the Court of Claims. Petitioner argues as if the issue presented in this case was a problem in accounting. Consequently, and perhaps intentionally, the argument adroitly and sedulously avoids and circumvents the actual issue in this case. That issue is simple: "Was the excess bonus paid to taxpayer in 1944 as a result of a mutual mistake of taxpayer and the Company, and repaid by taxpayer to the Company in 1946, taxable income of the taxpayer?"

That "points of time be fixed between which income is to be measured for tax purposes" and that "net income shall be computed upon the basis of taxpayer's annual accounting period" (Petitioner's Brief, pp. 9-10, 15-17), that the "claim of right" doctrine of *North American Oil Co.* v. *Burnet*, 286 U.S. 417, "follows as a necessary corollary" (Petitioner's Brief, pp. 10, 17-24), that "earnings or gain is taxable in the year of receipt even though the taxpayer's right to the money is subject to dispute or even though it is subject to an obligation to restore, which is admitted or uncontroverted, but at the same time, contingent or indefinite" (Petitioner's

Brief, pp. 11, 24-34), may be accounting or legal questions of importance in other matters or cases. But they are irrelevant in this case, and do not govern or even affect the determination of the issue here presented. Yet they constitute all the basic points of petitioner's argument.

Petitioner's propositions relating to annual accounting and the *North American Oil* case are applicable only when the receipt involved is actually taxable income. They do not determine what is or is not income, which is the issue in this case, nor have they any bearing upon that issue. Likewise, the law relating to the receipt of that which is concededly income, but subject to a contingent liability to restore, has no application. Obviously, the contingency may never occur and, therefore, the obligation to restore may never arise. Also, such obligation, if it ever arises, does not arise until the contingency occurs. In the instant case there was no contingency or indefiniteness involved. When money is received by a person because of a mistake, it does not belong to the recipient, and there exists, from the moment of its receipt, an unconditional and definite obligation upon him to return it.

Petitioner has tersely summarized its argument in its statement that "The issue here is, essentially, in what year shall the balancing deduction be taken—the year of receipt or the year of refund" (Petitioner's Brief, p. 12). That, as we have said, is not the issue here. It follows that, as petitioner has misconceived the issue, and consequently has argued around it, and not on it, most of its argument and the cases cited in support thereof are not germane and require no answer.

On pages 14-15 of its brief, petitioner recites what it claims "are the undisputed facts upon which it must be determined whether or not the bonus constituted in-

come to taxpayer in 1944." Petitioner's statement is not correct. Its recital of the facts omits the most salient fact,—that the taxpayer received the excess bonus because of and as a result of a mistake. This is the vital and basic factor which distinguishes this case from practically all of the income tax cases cited and relied upon by the petitioner.

Following a trail that leads nowhere, so far as the determination of the issue here is concerned, petitioner theorizes that the decision below tends to foster delayed payment and speculation on the part of the irresponsible and unscrupulous at the expense of the Government and the general body of law-abiding taxpayers. If some taxpayers are irresponsible and unscrupulous, that is too bad; they may pay no taxes at all. Their irresponsibility and unscrupulousness have as much bearing upon the issue here as the fact that some people live without benefit of clergy has upon the validity of a marriage. Actually, the person who receives income as the result of a mistake will always pay his income taxes promptly (if he is not irresponsible or unscrupulous) because he does not know until later that a mistake has been made.

Petitioner also speculates that, if the judgment below is affirmed, eventual collection of income taxes may be imperiled because some taxpayers may have the financial ability to pay their taxes in one year and may not have that ability in another year. We suggest that the question, whether the excess bonus the taxpayer received in 1944 was or was not taxable income, cannot be determined by speculating on the financial ability of other taxpayers to pay in one year and not in another year.

Petitioner also asks this Court to reverse the judgment below because of the Government's sympathy for a tax-

payer who may not be able to obtain a refund because he may not have repaid the money to which he was not entitled until after the Statute of Limitations has run upon his claim for refund. This possible situation may be a hardship in some case upon some taxpayer, but it has nothing to do with the issue here. There are many hardships in the Income Tax Law. For instance, a taxpayer, because of a mistake in computation, may pay income taxes which he does not owe, but if said taxpayer or the Government does not discover the mistake within the refund period, said taxpayer cannot obtain a refund and simply loses the amount of the tax which he did not owe and which he should not have paid.

One main contention of petitioner seems to be that, because tax accounting must be on an annual basis, if the judgment entered by the Court of Claims is affirmed, the entire revenue of the United States would have havoc wreaked upon it.

This contention, we suggest, is the product of a vivid imagination. Of course, the revenues of the United States must be determined on an annual basis, and that is exactly what the taxpayer is contending for, and nothing in the principles which sustain the judgment below contravenes this rule. That tax accounting of the United States must be on an annual basis means, in essence, no more than that a taxpayer's annual tax shall be based upon events which occur entirely within the tax year. That proposition is not violated by the decision below. All of the events which deprived the excess bonus received by the taxpayer of the character of taxable income occurred in 1944. The decision of the Circuit Court of Cook County, Illinois in 1946 merely recognized and confirmed what actually occurred in 1944. If the

fears of petitioner were well grounded, then the finances of the United States should have been thrown into chaos by the decision of this Court in *Freuler* v. *Helvering*, 291 U.S. 35.

In that case the beneficiaries of a trust had been paid the entire income of the trust in the taxable year. They paid income tax only on a part of the income received by them, excluding from their taxable income a certain amount which they had received because the trustee had not retained that amount for depreciation purposes. The Commissioner assessed a deficiency. Many years subsequent to the taxable year and to the actual distribution of the income, the state court having jurisdiction over the trust determined that the trustee should not have distributed the entire income but should have withheld and retained for remaindermen a certain amount for depreciation, and ordered the beneficiaries to repay the excess amounts to the trustee. The beneficiaries complied with this order; not by repaying the amounts, but by giving their non-interest bearing promissory notes to the presumptive remaindermen, payable at the time the remainders should vest in possession. This Court held that the beneficiaries were not taxable upon the amounts paid them in excess of what they should have been paid in the proper administration of the trust. The statement of the Court of Claims below concerning the *Freuler* case is a complete answer to petitioner's contention that, because Government tax accounting must be on an annual basis, an affirmance of the judgment below would wreak havoc upon the Government's finances. The Court of Claims said, concerning this Court's decision in the *Freuler* case:

> "The fact that the court so interpreted the statute as to make taxability depend upon the outcome of litigation as to whether the beneficiaries actually receiv-

> ing the income were legally entitled to keep it or not seems to us to discount very heavily the idea that the finances of the nation would be thrown into disorder if the Government were allowed to tax as income only that which is, in fact, income to the taxpayer, and not that which only seems to be income because he is mistaken as to his right to keep it." (R. 11).

Petitioner says,—what it considers to be a conclusive argument,—that: "The uniform result of the established system has been denial both to Government and to taxpayers of the privilege of allocating income or outgo to a year other than the year of actual receipt or payment" (Petitioner's Brief, p. 14). Petitioner's statement is true if the money received by the taxpayer is "income"; the statement is not true if the money received by the taxpayer is not income. *Freuler* v. *Helvering*, 291 U.S. 35, so holds.

Furthermore, Congress has recognized that the finances of the Government will not, as feared by the petitioner, collapse if the doors are not firmly barred and sealed at the beginning and end of an annual period. Petitioner's brief itself cites various sections of the Internal Revenue Code which provide for adjustment of a prior year's taxes by reason of subsequent events. (Foot-note 7, Petitioner's Brief, p. 35).

The administration of the Internal Revenue Code is replete with instances which refute petitioner's argument. A few illustrations will suffice: In 1944, A receives money which he erroneously and mistakenly believes is income and reports it as such. In 1946, the Commissioner of Internal Revenue determines that the transaction was a gift and not income to A. Assuredly the Commissioner would not hesitate to refund the excess tax paid by A for 1944.

If A, in March, 1945, files his income tax return for 1944 and makes a clerical error in that return, or includes in his income for 1944 that which is not income, or excludes from his income for 1944 that which is income, it is his duty and it is the duty of the Commissioner of Internal Revenue to correct the mistake. The result is that A, when the mistake is discovered, pays an additional tax for 1944 or is refunded part of the tax he paid for 1944. He does not pay an additional tax or make a deduction from his income for the year in which the mistake is discovered.

The Company, in March, 1945, in its income tax return for 1944, took a deduction for the entire compensation, including the excess bonus paid to the taxpayer in 1944. When, later in 1945, the Company discovered the mistake it had made, it filed an amended 1944 return and paid an additional tax (R. 9). The taxpayer paid income tax on the entire compensation received by him in 1944, including the excess bonus for that year. Had the Company waited until the excess bonus had been repaid to it in December, 1946, and then had attempted to include the money repaid to it in its 1946 return, and at the same time to have stood by its original 1944 return, would the petitioner have approved? It certainly would not have.

As petitioner's propositions concerning the necessity of annual accounting are irrelevant to, and not helpful in determining, the issue in this case, there would be no purpose in discussing the cases cited and quoted from by petitioner in support of said propositions. The many other cases, cited and relied upon by petitioner in support of the "claim of right" theory, will be referred to under taxpayer's Points II and III.

II.

The Excess Bonus Received By Taxpayer In 1944, As The Result Of A Mistake, Was Not Taxable Income Of The Taxpayer.

The petitioner's claim is that the taxpayer received the excess bonus in 1944 under a claim of right; that, therefore, the so-called "claim of right" doctrine applies to this case and under it the taxpayer is not entitled to a refund of the income taxes he paid for 1944 on the excess bonus.

In asserting this position, petitioner ignores the fundamental fact that the taxpayer, when in 1944 he received the excess bonus, was not entitled to it and that he received it because of a mistake. Both the Circuit Court of Cook County, Illinois, and the United States Court of Claims so found (R, 7, 9) and that finding is not before this Court for review.[1] This fundamental fact makes the so-called "claim of right" doctrine inapplicable to this case and entitles the respondent to a refund of the income taxes paid by him on said excess bonus.

When the taxpayer received the excess bonus he was not entitled to it; although he got physical possession of it in 1944, it never belonged to him, he did not have title to it, and from the moment that he received it, he was under the definite, unconditional obligation to return it.

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[1]See Specification Of Errors To Be Urged (Petitioner's Brief, pp. 8-9). Petitioner indirectly attempts to contest this finding (Petitioner's Brief, p. 32), which petitioner has no right to do. Petitioner also says, p. 32, "Certainly, it is not pertinent to the present problem that in any litigation one party or the other, or both, may be said to have been mistaken on the facts or law." Not only is it pertinent, but it is the crux of this case.

It was, therefore, not a part of his 1944 taxable gross income within Sec. 22(a) of the Internal Revenue Code.

The law is that one who receives money under a mistake is subject to the definite, unconditional obligation to repay or return said money, and that said obligation arises at the moment that the money was received.

Leather Manufacturers' Bank v. *Merchants Bank*, 128 U. S. 26;

New York Life Insurance Company v. *State*, 192 Wis. 404;

Poindexter v. *The Equitable Life Assurance Society*, 127 W. Va. 671;

International Bank v. *Bartalott*, 11 Ill. App. 620;

Richardson v. *Bales*, 66 Ark. 452;

Sturgis v. *Preston*, 134 Mass. 372;

5 *Williston on Contracts* (Rev. Ed.) § 1574 and cases there cited;

American Law Institute, *Restatement of Law of Restitution*, §§ 18, 20.

In the *Leather Manufacturers' Bank* case, this Court held that, if a bank, upon which a check is drawn payable to a particular person or order, pays the amount of the check to one presenting it with a forged endorsement of the payee's name, both parties supposing the endorsement to be genuine, a right of action to recover back the money accrues at the date of the payment, and the statute of limitations begins to run from that date.

The *New York Life Insurance Co.* case presented a situation on this proposition practically identical with that in the instant case and the decision there unequivocally demonstrates that taxpayer's obligation to repay the excess

bonus arose at the time it was paid to him and not at the time of the decree of the Circuit Court of Cook County, Illinois. The New York Life Insurance Company was a New York corporation doing business in Wisconsin. The Wisconsin law in effect in 1917 and 1918 provided, in substance, that a foreign insurance company should pay the same license tax as a Wisconsin insurance company was required to pay to the domicillary state of the foreign corporation by the laws of such state. At that time the ruling of the New York State Tax Department was that the New York law required a Wisconsin corporation to pay a tax of 1% of its gross receipts without any deduction for refunded premiums. The New York Life Insurance Company paid its tax to Wisconsin on that basis. Thereafter it was held by a New York court that the ruling of the New York State Tax Department was erroneous and that a deduction should be allowed for refunded premiums. Plaintiff sued to recover the license taxes it had paid to Wisconsin in excess of what it should have paid, based upon the New York law, as the New York court had found it to be. Suit was begun more than six years after the payment of the Wisconsin tax had been made, but less than six years after the decision of the New York court. The defense of the six year Statute of Limitations was interposed. The Wisconsin Court held that the cause of action accrued and the Statute of Limitations began to run when the excess payment was made to the State of Wisconsin and not when the New York court decided what the law of New York was.

In the *Poindexter* case, excess premiums were paid to an insurance company as a result of the mutual mistake of the insured and the insurer. The court said (pp. 681-682):

> "The payment and receipt of these excess sums was a purely mutual mistake, raising no blame against either party. * * * The insured had the absolute right to recover these excess payments from the instant they were paid, and the insurer the duty, equally absolute, to repay them. This stood their rights immediately after the payments."

The factual situation in this case makes irrelevant almost all of the cases relied upon by the petitioner. Its first group of cases are those where, in the words of petitioner, "the earning or gain has been held taxable in the year of receipt, even though, * * * the taxpayer's right to the money is subject to dispute, and liability to restore its equivalent may be, or is being, asserted." (Petitioner's Brief, pp. 25-27). When the taxpayer was paid the excess bonus there was no dispute.[2] It was paid to him because the Company and the taxpayer mistakenly believed at that time that he was entitled to it. There could not have been a dispute because the fact that the money was paid by reason of a mistake negatives the possibility of a dispute.

The next group of cases relied upon by petitioner are those which have held the tax properly collected in the year of receipt "even though the income is subject to an obligation to restore, which is admitted or uncontroverted, but at the same time, contingent or indefinite." (Petitioner's Brief, pp. 27-29). Petitioner itself has characterized these cases as follows:

> "In each of these cases * * * there were present at the time of receipt a bona fide claim of right to the alleged gain, title to it and unrestricted freedom in disposition, and there was absent a definite, unqualified and unconditional obligation to repay or return its equivalent."

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[2] Petitioner concedes this. See Petitioner's Brief, p. 37.

Petitioner's characterization of these cases distinguishes them from the instant case. In this case, at the time of receipt, there was present, not absent, a definite, unqualified and unconditional obligation to repay or return the excess bonus.

In the instant case, the events which fixed the rights and obligations of the taxpayer and the Company occurred in 1944. The direct and unconditional obligation of the taxpayer came into existence immediately at the moment the excess bonus was received. It did not arise for the first time in 1946, when the Circuit Court of Cook County, Illinois ordered the taxpayer to return the excess bonus. The decree of the Circuit Court was simply declaratory of the direct, unconditional obligation which came into existence in 1944.

Analogous situations are innumerable. For instance, if a statute is declared unconstitutional and void by a court of last resort, there is no doubt that the statute was void from the date of its enactment. Likewise, there is no doubt that, if a contract is declared void because it is against public policy, it was void from its inception.

The case of *Freuler* v. *Helvering*, 291 U.S. 35, is also decisive of this principle that the decree of the Circuit Court of Cook County did not create the obligation of the taxpayer to return the money, but that the obligation came into existence in 1944, and the decree of the Circuit Court was merely declaratory of that obligation. The facts in the *Freuler* case have been previously stated (*supra*, p. 13). This Court there held that the income of the trust received by the beneficiaries was not taxable income, because the state court had held, years after said money was paid, that it was mistakenly paid to the beneficiaries and had ordered them to repay it, which

they had done. If the obligation to repay had not come into existence immediately upon the receipt of the money, this Court should have sustained the Commissioner's assessment on the money so received and allowed the beneficiaries a deduction in the year in which they repaid the money.

The essence of petitioner's argument is that whatever money is received by taxpayer is taxable income. This is not what Section 22(a) of the Internal Revenue Code says. Taxable income, under that section, must be gains or profits or income. The money paid to the taxpayer as the result of a mistake, and to which he was not entitled and which he was under obligation to return from the moment he received it, was neither gain nor profit nor income. The mere fact that it was received by him did not make it income. The principles governing this situation were clearly set forth by this Court in the *Freuler* case.

It was there held that, since it had been determined by the state court that certain income from a trust should never have been paid to the beneficiaries thereof, that they were not entitled thereto, and that they were obligated to repay the same, said income was not taxable income. This Court said (p. 42):

> "* * * The test of taxability to the beneficiary is not receipt of income, but the present right to receive it. Clearly an overpayment to a beneficiary by mistake of law or fact, would render him liable for the taxable year under consideration, not on the amount paid, but on that payable."

The dissent of Justices Cardozo, Brandeis and Stone in that case was not based on any dissent from the principle announced above, but on the position that the bene-

ficiaries had not in fact repaid to the trustee that part of the income to which the beneficiaries were not entitled. The principle determining the case and which is determinative of the instant case was approved in the dissenting opinion.

In the instant case, the taxpayer paid the tax on the excess bonus in 1945, when he paid his 1944 income tax, and in 1946 repaid in full to the Company the amount of the excess bonus.

Petitioner attempts to distinguish the *Freuler* case (Petitioner's Brief, pp. 23-24) on the ground that said case involved only the construction of Sec. 219(d) of the Revenue Act of 1921 and was merely an example of an express statutory exception to the general principle of annual accounting. The distinction made by petitioner is not valid. The exception made in Sec. 219(d) to the general principle of annual accounting was not involved in the *Freuler case*. Insofar as Sec. 219(d) taxed income "distributable", it referred to income which the beneficiary was entitled to receive, but had not actually received.[3]

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[3]The pertinent part of Sec. 219(d) provided:

"(d) * * * there shall be included in computing the net income of each beneficiary that part of the income of the estate or trust for its taxable year which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not * * *." (Emphasis supplied)

The Court below recognized the speciousness of petitioner's attempt to distinguish the Freuler case. In this connection it said:

"We recognize, of course, that the Freuler case involved a special section of the Revenue Act which had its own wording. The use in that section of the word 'distributable' would seem to be accounted for by the fact that Congress intended to tax to beneficiaries money which was in fact available or owing to them by their trustees, even before it had actually been paid over to them." (R. 10-11).

Section 219(d) made no special provision different from the general concept of income contained in Sec. 22(a) with reference to moneys actually received by the beneficiary. Consequently, the decision in the *Freuler* case did not turn upon any special statute, but turned upon the principle that money received as the result of a mistake of law or fact, and later returned, does not constitute income to the recipient.

The legal principle of the *Freuler* case, that money received by reason of a mistake and which is later repaid is not taxable income to the recipient, which is the principle that controls this case, was followed in

Saltonstall v. *Hassett, et al.* (U.S.D.C. Mass. 1940) 32 F. Supp. 583.

There the beneficiary of a trust sued for a refund of income taxes paid on money she received from the trustees, which the trustees and the beneficiary subsequently determined had been paid because of a mistake. In holding that the beneficiary was entitled to a refund, the Court said, in part, (p. 588):

> "Under the circumstances it is obvious that some of these amounts were paid to the plaintiff by mistake and she was burdened with the obligation of paying them back. * * * These payments * * * upon which the plaintiff paid tax, were not taxable income to the plaintiff, but should be taxed to the trustees. This is plainly so under the doctrine of *Freuler* v. *Helfering*, 291 U.S. 35, 42."

We submit that it is the law, and that this Court has so held, that money paid to a person which actually was not his and to which he was not entitled and which was paid to him because of a mistake of law or fact and which he later repaid, is not taxable income. The multitude of

cases cited by petitioner, with the possible exception of one or two, do not contravene that legal principle. Incidentally, a considerable number of cases cited by petitioner do not have even a remote bearing upon the issue in this case. We believe that an analysis of this Court's decisions in the three cases of *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, *Freuler* v. *Helvering*, 291 U.S. 35, and *Commissioner* v. *Wilcox*, 327 U.S. 404, will amply suffice to determine that taxpayer's position is correct and that the judgment of the Court of Claims should be affirmed. A goodly number of lower courts' decisions might be cited to sustain the legal principles advanced by taxpayer. The only weight that they would carry is due to the possible persuasiveness of their argument, and it is our thought that it is unnecessary to burden this Court by discussing them.

III.

The So-called "Claim Of Right" Doctrine Is Not Applicable To The Facts In This Case.

Except for its emphasis upon the rule of annual accounting, which we have already discussed, petitioner's sole claim is that the taxpayer received the excess bonus in 1944 under a claim of right; that, therefore, the so-called "claim of right" doctrine applies to this case and, consequently, the taxpayer is not entitled to a refund of the income taxes he paid for 1944 on the excess bonus.

In asserting this position petitioner glosses over the fundamental fact that the taxpayer, when in 1944 he received the excess bonus, was not entitled to it, that he received it because of a mistake, and that at the time he received it he was under the direct and unconditional obligation to return or repay it. This fundamental fact

makes the "claim of right" doctrine inapplicable to this case. We believe that this Court has already so held. Reason and every principle of equity support that conclusion.

It is true that, when the taxpayer received the excess bonus he believed that he was entitled to it. But the existence of that belief does not bring this case within the "claim of right" doctrine, although the petitioner apparently bases its case entirely upon the fact of said belief. The belief of the taxpayer was based upon a state of facts which did not exist. Had the taxpayer and the Company then been cognizant of the true facts, said taxpayer would not have been paid the excess bonus. The result of the then lack of knowledge of said taxpayer and the Company was a mistake and the belief of taxpayer that he was entitled to the excess bonus was based upon the same non-existent facts which resulted in the mistake. Such a belief does not constitute a "claim of right". The mistake neutralizes the "claim of right". This principle has been clearly stated by the Court of Claims in

Greenwald v. *United States*, 57 F. Supp. 569, and
Gargaro v. *United States*, 73 F. Supp. 973.

In the *Greenwald* case the Court said (p. 572):

> "This doctrine [the 'claim of right' doctrine] has been applied in many cases. The plaintiff urges that it is not applicable here, because his receipt of the bonuses was due to a mistake of fact. * * * We agree with the plaintiff. * * *

(p. 573):

> "We conclude, therefore, that the 'claim of right' doctrine does not apply to the plaintiff's situation. He overpaid his taxes because of a mistake of fact."

In the *Gargaro* case the Court said (p. 975):

> "Plaintiff's claim of right in this case, as in the *Greenwald* case, *supra*, was neutralized by the fact that he was ignorant of the relevant facts."

Petitioner contends that this Court's ruling in *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, announcing the "claim of right" doctrine, is controlling here and that it is a corollary of the principle of annual accounting, so voluminously discussed by petitioner. If it be conceded that the rule announced in the *North American Oil* case is a corollary of the annual accounting principle, then that points up the fact that the "claim of right" doctrine of the *North American Oil* case does not control this case, but on the contrary has no application thereto. For, as we have shown, the annual accounting principle does not determine what is or is not taxable income.

In that case the United States had brought suit before 1916 in the U. S. District Court to oust the taxpayer from possession of oil land. The Court appointed a receiver in 1916 to operate the property and hold the profits. In 1917 the Court entered its final decree dismissing the suit and the receiver thereupon paid to the taxpayer the 1916 profits on the property in his hands. The United States appealed the decree; in 1920 the Circuit Court of Appeals confirmed; and in 1922 the Supreme Court dismissed the Government's further appeal. In 1918 said taxpayer had included the 1916 profits on the property, paid to the taxpayer by the receiver in 1917, in an amended return for 1916. The Commissioner of Internal Revenue contended that said profits were taxable income for 1917, when they were paid to the taxpayer by the receiver. The taxpayer contended that

they were either 1916 income or income for 1922, when the taxpayer's right to the profits was finally confirmed. The sole question before this Court was, in what year the profits should have been reported and taxed as income. This Court held that the profits were income in 1917, the year they were actually received by the taxpayer.

There was no issue as to whether the profits were taxable income; the Court said (p. 422): "It is conceded that the net profits earned by the property during the receivership constituted income."

In attempting to distinguish the case of *Freuler* v. *Helvering*, 291 U.S. 35, which we have previously discussed, petitioner says (Petitioner's Brief, p. 23) that the *Freuler* case did not have any bearing on the "claim of right" doctrine announced in the *North American Oil* case, because this Court, referring in the *Freuler* case to the *North American Oil* case, said: "Section 219 had no bearing upon the question presented." Actually, what this Court said in the *Freuler* case was (p. 42):

> "The respondent relies on *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 76 L. ed. 1197, 52 S. Ct. 613. That case, however, involved the receipt of income in 1917 through a money award of a court. An appeal was taken and the award was not confirmed by the appellate court until 1922. The taxpayer's claim that the possibility of reversal shifted the receipt of the income to the latter year was overruled. Section 219 had no bearing upon the question presented."

Following the reasoning of the petitioner, the inapplicability of the *North American Oil* case becomes patent because Sec. 22(a) of the Income Tax Code was not involved in that case; in other words, what is taxable income was not the issue there.

The *North American Oil* case was decided in 1932. In 1946, subsequent to the date of most of the cases relied upon by petitioner which follow the *North American Oil* case, this Court decided the case of

Commissioner v. *Wilcox*, 327 U.S. 404,

and there stated explicitly the "claim of right" rule as applied to Sec. 22(a) of the Internal Revenue Code. That case, and not the multitude of "claim of right" cases cited by petitioner, is decisive of the instant case. There was a dissent by Justice Burton and the principal cases relied upon in the dissenting opinion, *National City Bank* v. *Helvering*, 98 F. 2d 93, *Barker* v. *McGruder*, 95 F. 2d 122, and *Chi. R. I. & P. R. Co.* v. *Commissioner*, 47 F. 2d 990, are also relied upon by petitioner in the instant case.

In the *Wilcox* case, Wilcox had embezzled certain funds from his employer, later gambling and losing them. He failed to report the embezzled moneys as income and the Commissioner sought to assess a deficiency. This Court held that the embezzled funds did not constitute income within Sec. 22 (a) of the Internal Revenue Code and rejected the Commissioner's contention that the "claim of right" doctrine was applicable. This Court said, in part, (p. 408):

> "For present purposes, however, it is enough to note that a taxable gain is conditioned upon (1) the presence of a claim of right to the alleged gain and (2) the absence of a definite, unconditional obligation to repay or return that which would otherwise constitute a gain. Without some bona fide legal or equitable claim, even though it be contingent or contested in nature, the taxpayer cannot be said to have received any gain or profit within the reach of § 22 (a). See *North American Oil Consolidated* v. *Burnet*, 286 U.S. 417, 424, 76 L. ed. 1197, 1200, 53 S. Ct. 613. Nor can taxable income accrue from the mere receipt of

property or money which one is obliged to return or repay to the rightful owner, as in the case of a loan or credit. Taxable income may arise, to be sure, from the use or in connection with the use of such property. Thus if the taxpayer uses the property himself so as to secure a gain or profit therefrom, he may be taxable to that extent. And if the unconditional indebtedness is cancelled or retired, taxable income may adhere, under certain circumstances, to the taxpayer. But apart from such factors the bare receipt of property or money wholly belonging to another lacks the essential characteristics of a gain or profit within the meaning of § 22 (a)."

Under the facts in the instant case, the claim of right doctrine is not applicable because neither of the tests laid down in the *Wilcox* case has been met.

First, there was no presence of a "claim of right" to the excess bonus. The belief of the taxpayer and the Company that taxpayer was entitled to the money, being based upon a mutual mistake, is not a "claim of right" by taxpayer at all. (See p. 25, *supra*).

Second, as we have previously shown, there was a definite, unconditional obligation on the part of the taxpayer to repay or return the excess bonus, which obligation arose at the moment he received the bonus.

Petitioner says that the *Wilcox* case did not overrule or modify the rule of the *North American Oil* case. If it did neither, it certainly clarified the claim of right rule. Petitioner also says that the taxpayer received the money under claim of right, continuously maintained by him under the most "solemn circumstances", and that "His obligation to repay was not definite, unconditional or unqualified, but, on the contrary, was disputed and settled only after litigation." Thus petitioner concedes that if

the taxpayer's obligation to repay was definite, unconditional and unqualified, the claim of right doctrine does not apply. We believe that we have shown that when money is paid under a mistake, as it was here, the recipient's obligation to repay is definite, unconditional and unqualified, and that the decree of the Circuit Court of Cook County, Illinois, was a declaration of what was a fact.

The discussion of the *Wilcox* case and of petitioner's interpretation of the *Wilcox* case, in the opinion below, is apt. The Court of Claims said:

> "The *Wilcox* case concerned the taxability of an embezzler upon the proceeds of his crime. His duty to repay would certainly not lose its quality of being 'a definite, unconditional obligation' merely because at first he denied his crime and claimed that the money taken was his own, and persisted in that claim until he was convicted of the embezzlement. And the duty to repay of one civilly indebted because he had received money by mistake is no less 'a definite, unconditional obligation' because he refuses to recognize the obligation until the contract in connection with which he mistakenly received the money has been interpreted and enforced by adjudication." (R. 10)

The effect of the *Wilcox* case upon the *North American Oil* case is discussed at some length in *Gargaro v. United States*, 73 F. Supp. 973.

IV.

The Position Of The Government Is Unjust And Unfair To The Taxpayer.

The Circuit Court of Cook County, Illinois and the Court of Claims, found that the agreement between the

taxpayer and the Company was that the taxpayer's bonus for 1944 was to be ten per cent of the net profits of the Company *after* taxes (R. 7, 9). Therefore, when the taxpayer was paid and received the excess bonus (the difference between ten per cent of the net profits of the Company before taxes and ten per cent of the net profits after taxes) only one of two possibilities existed: Either (1) the taxpayer embezzled the excess bonus because he caused the Company to pay it, and he received it, knowing that the agreement between him and the Company was that his bonus was to be computed after taxes; or (2) he caused the Company to pay it, and he received it, as the result of a mutual mistake by the Company and by him. Upon the authority of *Commissioner* v. *Wilcox*, 327 U.S. 404, if the taxpayer embezzled the excess bonus, he is entitled to a refund. It would indeed be an anomaly if the taxpayer were entitled to the refund claimed by him if he embezzled the excess bonus, but not entitled to if, if he received it as the result of an honest mistake.

Concerning this situation, the Court of Claims said in *Gargaro* v. *United States*, 73 F. Supp. 973, at page 975:

> "We are asked to hold that an honest man who received money under a mistake and immediately restored it when the mistake was discovered, must pay an income tax upon it, whereas an embezzler who received money and used it (we suppose it is immaterial that he lost it in gambling) and did not restore it to the rightful owner, owes the Government no tax. We would suppose that if there was to be a difference in the treatment of these two situations, the difference should be that the honest taxpayer would be treated more considerately than the embezzler."

In 1944 the taxpayer received the excess bonus as the result of an honest mistake, and he paid taxes upon it. The Company deducted the excess bonus paid to the tax-

payer as an expense of the business and paid income taxes accordingly (R. 6). In 1945 the Company filed an amended return in which it deducted, as bonus compensation to taxpayer, the sum of $11,067.94 instead of the $21,924.00 deducted in its original return, and paid the additional tax based on the recomputation (R. 6). Therefore, the Government has received as income taxes for 1944, from the Company, its taxes based upon a deduction of the amount which was actually due to the taxpayer and which was $10,856.06 less than the amount that he was mistakenly paid in 1944, and, from the taxpayer, taxes based upon the amount mistakenly paid to him, and which was $10,856.06 in excess of the amount to which he was entitled. Thus, both the Company and the taxpayer paid income taxes for 1944 upon the excess bonus, which the taxpayer later refunded. Under no theory of consistency, fairness or justice can petitioner maintain the position that it is entitled to the additional income tax paid by the Company for 1944, but that the taxpayer is not entitled to a refund of the additional income tax for 1944 paid by him. As has been said by the Court of Claims in this case and similar cases, the Government's retention of the tax in this case is essentially unjust, and there is nothing to be said for it morally.

The unfairness and injustice of the petitioner's position has been well characterized in this case and previous similar cases by the Court of Claims. In *Greenwald* v. *United States*, 57 F. Supp. 569, the Court said (p. 573):

> "Where, however, one pays income taxes upon income which he physically receives, but which he is not allowed to keep, the Government's retention of the tax is essentially unjust. In a case such as the instant one, where, due to ignorance of fact, the tax-

payer had no choice in the matter, that injustice is complete."

In *Gargaro* v. *United States*, 73 F. Supp. 973, the Court said (p. 974):

> "We were impressed in that case, and, of course, are similarly impressed here, with the injustice of the Government's position. For the Government to insist upon keeping taxes paid to it by a taxpayer under the mistaken belief that he has received income for his own use and benefit, when in fact he received it only by reason of an honest mistake, and was obliged to and did give it back and got no benefit from it, there is nothing, to be said morally. If the Government can do this, it is only because the law is plainly so written, or because a fairer interpretation of an unclear law would throw the public revenues into serious confusion.
>
> "As to the law being plainly so written, it is not."

In the opinion below, the Court said:

> "We remind, however, that in the instant case, as also in the *Greenwald* and *Gargaro* cases, *supra*, the taxpayer having received the income, paid his tax, and did not ask the Government to wait for its revenue until he had completed his litigation or resolved his question otherwise. In all these cases the naked question has been whether the Government should keep money paid to it upon the mistaken assumption that the citizen had taxable income, when in truth he did not have the income, since he was under a legal obligation to return the money to his employer." (R. 11).

From every point of view of the equities of the situation, as well as the law, the respondent is entitled to the refund to which the Court of Claims said he was entitled.

Conclusion.

For the foregoing reasons, it is respectfully submitted that the decision of the Court of Claims should be affirmed.

Respectfully submitted,

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No. 347

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, A. D. 1950.

UNITED STATES OF AMERICA,
Petitioner,

vs.

ELLIS R. LEWIS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION OF ELLIS R. LEWIS FOR REHEARING.

SIGMUND W. DAVID,
Attorney for Respondent.

ARTHUR C. CHAPMAN,
Of Counsel.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

PETITION OF ELLIS R. LEWIS FOR REHEARING.

Ellis R. Lewis, respondent in the above entitled cause, presents this petition for a rehearing and in support thereof respectfully shows:

JURISDICTION.

This Court, on March 26, 1951, rendered its decision reversing the judgment of the Court of Claims of the United States. This petition is filed within fifteen days thereafter, under Rule 33 of the rules of this Court.

REASONS FOR GRANTING REHEARING.

I.

The Decision Is Unnecessary To, And In No Way Facilitates, The Proper Administration Of The Income Tax Law.

This petition is not filed under any illusion that because of the brevity of the opinion announced, this Court has not fully and carefully considered the arguments and issues in this case. It is respectfully suggested, however, that, in its desire to render a decision the practical effect of which would facilitate the administration of the income tax law—in its desire to retain as inviolate as possible the principle of annual accounting—this Court has unnecessarily swept aside fundamental legal principles and the logic and equity of the case at bar. There is no need to again argue the law in this case; that has already been done.

It seems inescapable that the core of this Court's decision is found in the last paragraph of Mr. Justice Black's opinion. Finality, it would appear, must be given to the annual accounting period, and that is the reason for the "claim of right" doctrine. This Court has in effect said that this case falls within the reason and rationale of the doctrine. Therein, it is submitted, lies this Court's error. Why does the theory of finality necessitate the "claim of right" doctrine? The Government has stated the reasons in its brief (pp. 11-14, 36, 37). It is said that the Government must not be made a party to private lawsuits; that payment of taxes should not await the outcome of private litigation; and—what ap-

pears to be the fundamental reason—that delay may imperil collection because the taxpayer may not later have the money to pay his taxes. Assuming that these are good and cogent reasons for the "claim of right" doctrine, they have no application in a case such as this.

"Income taxes must be paid on income earned (or accrued) during an annual accounting period" (Opinion, p. 2). But, in reality, the excess salary or bonus paid under and pursuant to a mistake, is not income. That is a simple, undeniable, economic and legal fact, and this Court has not said otherwise. This Court has, in effect, ruled, however, that the "claim of right" doctrine requires such excess salary or bonus to be treated *as though it were income*. According to this Court's decision, to do otherwise would be to depart from the "claim of right" doctrine. It is submitted that to impute to the mistaken excess payment a character different from that which it actually has, solely for supposed practical reasons, is not required by the "claim of right" doctrine, and does not, in fact, serve the practical ends sought to be accomplished. To treat the excess bonus on the basis of what it actually is would not be a departure from the "claim of right" doctrine, which is merely a rule of practicality.

It could easily be agreed that niceties of law and logic must at times be put aside to meet the realities of the Government's fiscal needs, and that a taxpayer must not be permitted to delay payment of his taxes pending a dispute, real or feigned, over his right to retain his receipts, or pending the determination of a contingency, the occurrence of which may require repayment of his receipts. But is any of that—the practical justification for the "claim of right" doctrine—applicable to money received under and pursuant to a mistake? Can the an-

swer be anything but "no"? If, as in this case, at the time of payment a mistake has occurred, there can be no delay in tax payment. The taxpayer does not know there has been a mistake, he knows no reason and can offer no excuse, real or feigned, for not paying his taxes. In fact he will pay his taxes, as did the taxpayer here. The Government has not been made a party to a private lawsuit; payment of taxes has not been made to await the outcome of private litigation; and collection of the tax is not imperiled because there is no delay and it is paid when due. If later the mistake is discovered and it is learned that there actually was no income and the taxpayer gets back his taxes, how is the Government harmed; how are its finances imperiled; how has the principle of annual accounting been violated? In no way, it is submitted. From the point of view of tax accounting and tax administration, the situation is essentially no different from that of any refund of taxes. If the unyielding rule announced is to be given full sweep, if the principle of annual accounting is to be given the ultimate protection, then all refunds must be barred. That, of course, is absurd. The result announced herein is, at the very least, equally unnecessary to preserve the inviolability of the principle of annual accounting.

Certainly this Court will agree that in the event of a mistake, simple justice requires that the taxpayer be restored to his original position—that the *status quo* be recreated insofar as possible. Likewise this Court must agree that the "claim of right" doctrine is a rule of convenience. As such, therefore, it is a matter of form or procedure—taxes must be paid when what appears to be income is received. If the taxes are paid in the first instance, as in this case, is not the rule of convenience satisfied? Should then this rule of convenience, of pro-

cedure, become a matter of substance so as to prevent a refund of the tax when the true facts are known? Did this Court intend such a result and intend to extinguish simple justice?

II.

This Court Has Overlooked One Of The Tests Of Taxability Laid Down By It In Commissioner v. Wilcox, 327 U. S. 404.

Great reliance has been placed upon *Commissioner* v. *Wilcox*, 327 U.S. 404, as sustaining the argument that the court below was correct and that the refund of taxes sought should be granted. This Court distinguished that case upon the ground that (Opinion, p. 2) "an embezzler asserts no 'bona fide legal or equitable claim' ". While it is true that the impossibility of an embezzler asserting a "claim of right" was a factor in the decision in that case, actually the greatest part of the opinion was devoted to the embezzler's lack of title; to the existence of his unconditional obligation to repay, which arose when he took the money. It is submitted that therein lies the true basis of the decision in the *Wilcox* case. At the very least, it was of equal significance with the absence of a "claim of right". The presence of that same unconditional obligation to repay, arising immediately upon the receipt of the excess bonus as the result of and pursuant to a mistake, has been argued at length herein already. Yet this Court makes no mention of that element of this case. It cannot be seen how the decision herein is not inconsistent with and contrary to the decision in the *Wilcox* case. All logic and reason insist that both decisions cannot stand. Either the *Wilcox* case must be disavowed or the judgment below must be affirmed.

III.

This Decision Is Manifestly Unjust, Places The Government In An Unconscionable Position, And Will Inevitably Lead To Further Inequitable And Undesired Results.

Adverting again to *Commission* v. *Wilcox*, 327 U.S. 404, a paradox is readily apparent. An embezzler who dissipates the fruits of his crime pays no tax, while one who makes an honest mistake and pays back the erroneously received money must pay a tax.

How can the Government in good conscience retain the tax imposed upon the recipient of the excess bonus and at the same time accept the tax paid by the taxpayer's employer on the same money when such employer amends its return, reduces its deduction to only the correct amount that should have been paid, and pays an additional tax?

How can the Government in good conscience retain a tax upon that which, when the true facts appear, is not income?

Putting aside the equities in this case, what are the consequences and the effect of this decision? Suppose a taxpayer is to be compensated upon a percentage of the sales which he makes. Suppose, further, that in computing his compensation a purely arithmetical error is made; the sales are added incorrectly, or the percentage calculation is erroneous, or both. Suppose, still further, that the result of the arithmetical error is that the taxpayer is paid more than he is entitled to receive. Under the decision in this case that taxpayer, having paid income taxes upon the full amount received, would not be entitled

to a tax refund when the error is discovered and the excess repaid. Let us consider another situation. Suppose an employee is required at the end of each week to report to his employer the total number of hours he has worked during that week, segregating his straight time and his overtime hours. Suppose this employee, being unlearned in the science of simple arithmetic, consistently and continuously makes mistakes in adding up his hours. Suppose the employer accepts the report of the employee and pays him upon the basis thereof. Suppose after the end of the year a check is made of the hours actually worked by the employee and it is discovered that, because of mistakes in addition, the employee has reported incorrectly the hours worked by him and has been paid more than he was entitled to receive. Under the decision in this case, that employee-taxpayer, having paid income taxes upon the full amount received, would not be entitled to a tax refund when the error is discovered and the excess repaid. Therefore, under this decision, if, because someone has not learned to add and subtract properly, a taxpayer receives more in pay than he is entitled to receive, he must pay a tax upon the excess, even if the error is discovered and the excess repaid one minute after the end of the annual accounting period. Annual accounting remains inviolate, but is not the result intolerable? If the decision of this Court stands, that unjust and certainly unintended result must come about as night must follow day. It is inconceivable that this Court intended to create such a rule.

CONCLUSION.

For the foregoing reasons, it is respectfully prayed that a rehearing herein be granted and that upon such rehearing this Court withdraw its present decision and, instead, affirm the judgment below.

Respectfully submitted,

SIGMUND W. DAVID,
Attorney for Respondent.

ARTHUR C. CHAPMAN,
Of Counsel.

April, 1951.

CERTIFICATE OF COUNSEL.

It is hereby certified that the foregoing petition for rehearing in this case is presented in good faith and not for delay.

SIGMUND W. DAVID,
Attorney for Respondent.